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OFFICE OF THE COMPTROLLER OF THE CURRENCY

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CONSUMER ELECTRONIC PAYMENTS TASK FORCE

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PUBLIC MEETING

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MONDAY
JUNE 9, 1997

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WASHINGTON, D.C.

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The Task Force met in the auditorium of the National
Aeronautics and Space Administration, 300 E Street, S.W., at 9:00
a.m., Gene Ludwig, Chairman, presiding.

PRESENT:

GENE LUDWIG, Chairman
ANDREW C. HOVE, JR.
EDWARD W. KELLEY, JR.
RUSSELL D. MORRIS
RICH OLIVER
CAROLYN BUCK
JODIE BERNSTEIN

ALSO PRESENT:

Matthew Miller
Bill R. Norwood
Lamar Smith
Glenn Weiner
Mark Budnitz
Mark Plotkin
Judie Rinearson
Margot Saunders
Jeff Marquardt
Ezra Levine
John M. Lewis
Janice C. Shields
Marcy Creque
Donet D. Graves
John Harshaw
Steven I. Zeisel

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P-R-O-C-E-E-D-I-N-G-S

CHAIRMAN LUDWIG: Good morning. Let me welcome you this morning before we ask our panelists to come up. I'm pleased to welcome everybody to the first public meeting of the Consumer Electronic Payments Task Force.

The emergence of the new electronic money products such as online and offline smart cards and Internet payments has generated a considerable amount of public interest as you well know and some concern about consumer issues.

Since these products generally are not subject to the same regulatory regime or industry standards that apply to more familiar payment mechanisms, such as credit and debit cards, there has been a lot of interest in the consumer issues.

As you may remember, the Consumer Electronic Payments Task Force was established by Secretary of the Treasury Rubin because he wanted to focus on this important dimension of smart card development and how it affects the consumer.

And we have been eager to have this public forum to hear from what is really going to be I think a very interesting group of panelists.

The mission of the task force is to identify consumer issues raised by electronic money to evaluate the extent to which these issues are being addressed by laws or industry practices and identify innovative, nonregulatory responses that may be needed for consumers in this developing market.

We think that consumers are most likely to benefit from and use E-money if they understand the risks as well as the benefits of the new products and if they know that their interests have been considered and dealt with properly.

In conducting our examination of consumer issues and concerns that these new products raise, the task force is especially interested in hearing from the public.

We will carefully evaluate these views in consideration of this issue. That is, these public meetings are of keen interest to us. And we are interested in what each of the panelists has to say.

In addition to today's public meeting, we will hold another public meeting on July 17. I think we expect that to be at the FTC.

These sessions are a great opportunity for discussion. We've tried to set it up in a fashion in which we really have dialogue as well as witness statements.

I might say that if anyone who's attending today wants to testify on July 17 at the public meeting, we have some copies of the Federal Register announcement of the meeting which are available on the table outside.

And I encourage you to take a good, hard look at it. Now, before I introduce our first panel, I'd like to introduce the representatives of the task force that are here today.

The issues that the task force are considering span the jurisdictions of a number of federal agencies. And that's why we have a fairly diverse membership.

Governor Edward Mike Kelley, Jr. is here from the Federal Reserve Board. Andrew Skip Hove is Chairman of the FDIC. Russ Morris is Commissioner of the Financial Management Service of the Department of the Treasury.

Carolyn Buck is Chief Counsel of the Office of Thrift Supervision. She's here on behalf of Director Retsinas.

Rich Oliver is Senior Vice President of the Federal Reserve Bank of Atlanta. He's here on behalf of Atlanta Federal Reserve Bank President Guynn.

Jodie Bernstein is Director of the Bureau of Consumer Protection at the FTC. She's here on behalf of Commissioner Pitofsky.

Now, I'd like to welcome our panelists to the podium. I see some of you in the audience. Great. We've got a full house.

We are very fortunate to have throughout the day a number of distinguished people who have been interested in this area, both as business people, commentarists, and consumer advocates.

The first panel consists of Matthew Miller, Senior Manager of Mondex USA; Bill Norwood, Vice President of new business development for CyberMark; Lamar Smith, Senior Vice President of government relations for Visa; and Glenn Weiner, Vice President of Smart Card Center of Excellence for American Express.

I want to thank you all for coming. We've asked that our speakers try to limit their opening remarks to five minutes, so we do have an opportunity for Q and As. Let's begin with Mr. Miller. Mr. Miller I'm interested in hearing your remarks.

MR. MILLER: Thank you. Good morning. My name is Matthew Miller. I'm a senior manager at Mondex USA, and I'm responsible for overall development and marketing positioning of the Mondex product.

In this capacity, I helped to design strategies for deploying Mondex electronic cash and other cash card applications in the United States marketplace. I thank you very much for the opportunity to share my thoughts on the impending smart card revolution.

This morning I'll focus my comments on three areas. First, I'll briefly describe Mondex USA and its purpose. Next, I'll highlight some current trends in the electronic commerce and smart card industries.

And finally, I'll discuss some plans for Mondex's development in the United States. Let me begin with Mondex USA.

Mondex USA, a for-profit, technology driven electronic payments company, announced its formation in December of 1996.

The organization is jointly owned by seven leading U.S.

financial services organizations, AT&T, Universal Card Services, Chase Manhattan, First Chicago NBD, MasterCard, Michigan National Bank, Novus, and Wells Fargo.

Although the companies' shareholders are financial services organizations, the very nature of Mondex's pioneering work in smart cards requires us to act like and move with the speed of Silicon Valley.

Mondex USA in many ways represents the changing landscape of the financial business, a change demonstrated by the convergence of high tech and banking.

The company marries the entrepreneurial spirit of a high tech start up that's blazing new frontiers in smart card technology with the powerful backing of major players in the financial services industry.

Mondex USA's singular mission is to propel Mondex electronic cash in the United States. As such, the company facilitates the products' commercial development, doing so through an open systems approach.

Mondex USA, not only openly licenses financial services organizations to issue cards and recruit merchants, but also solidifies strategic alliances in the technology arena to expedite the creation of necessary equipment and infrastructure.

Mondex USA is positioning itself to deliver rapidly consumer and retailer benefits associated with electronic cash.

With that organizational back drop, I would now like to set some context for Mondex's U.S. development by highlighting some trends and watershed events that we are all witnessing in the electronic commerce and smart card industries.

Let's begin by looking at some of these trends in electronic commerce. Today's payment system is largely paper based. In terms of absolute numbers, 94 percent of all consumer transactions are either in cash or check, with only about six percent completed via electronic payment instruments like credit and debit.

Of the paper-based transactions, the vast majority of those are in cash, the very market that we are targeting with Mondex.

McKinsey and Co. has estimated that more than 300 billion cash transactions occur in the U.S. each year. And the biggest percentage of these are for less than \$5.

With that said, times are changing. Electronic transactions are expected to explode in the coming years at a growth rate of about 20 percent per year in contrast to only a two percent rise in the number of paper-based transactions.

This significant increase in electronic transactions will be fueled by a number of factors including first Internet commerce. The rapid growth of the Internet as a commercial business medium will increasingly generate commerce and electronic payments between consumers and retailers.

The market opportunity for payments on the Internet is

substantial with forecasts ranging from 10 to 250 billion dollars by the year 2000. Unquestionably, the Internet represents one of the most fundamental changes to industry in society we have witnessed in decades.

Consumers, retailers, advertisers, financial services organizations, technology companies, the list goes on and on for those embracing the web in unprecedented fashion.

The Internet train is already barreling full steam ahead and leaving those not on board well in the distance. The second factor that will fuel electronic transaction growth are falling technology costs.

Moore's law, the notion that technology costs decrease by 50 percent every 18 months were said differently that processing power doubles every 18 months has been very well documented in Silicon Valley.

Experience with pagers, PCS, cellular phones, fax machines, and other technologies has clearly demonstrated that as the cost of technology falls dramatically and/or functionality increases, customers other than the early adopters will try and use these new products.

The Internet and smart card industry are both in their initial throes in the United States. However, as PCs, network computers, products like Web TV, smart cards and smart card readers continue to fall in price and become more powerful, inexpensive technology options will increase and proliferate in the mass market.

Home-based commerce using electronic appliances is on the horizon and will accelerate rapidly as costs continue to decline.

And the third factor that's going to drive electronic transaction worth is a revolution in retail marketing. The mass market is being increasingly replaced by a competitive niche markets.

This heightened competition puts an absolute premium on getting the right product to the right customer at the right time. Marketing to persons or segments of one requires tremendous, tremendous efficiency, efficiency that can only be accomplished via very inexpensive distribution channels.

Electronic distribution through the Internet enables businesses to reach millions of customers at virtually no cost.

The competitive playing field has been considerably leveled by minimizing the importance of physical locales. Those in the electronic commerce and payments business must position themselves to benefit from this marketing revolution.

The growth in electronic transactions is heavily dependent on new forms of money like electronic cash. In both the existing physical world as well as the emerging Internet environment, cash will continue to be the dominant form of payment.

The new opportunities for those in the payments

business is immense, particularly in the electronic cash arena. With my remaining time, I would now like to briefly describe Mondex's expected development in the United States.

To put the development of smart cards and Mondex in context, the historical revolution of the PC industry offers a very, very relevant analogy.

The parallels between smart cards and PCS are unmistakable, particularly for their technological foundations, microprocessor-based hardware, operating system software, and application specific software.

Smart cards truly represent a new generation of miniature personal computers, a PC in your pocket. Less than 20 years ago, the Commodore 64 was one of the very first home PCS.

Despite minimal memory, limited operating system functionality and dearth of software applications and languages, the Commodore 64 was truly considered revolutionary. In less than two decades, entire hardware and software industries spawned from the PC's development.

We're now just beginning to witness a similar pace of innovation in the fledgling smart card industry. Imagine that by mid-next year, sophisticated smart card computers with 16 K of memory will be available on a credit card size piece of plastic.

The recent announcement of Multos by key smart card players is an important step in creating an industry wide operating system standard, the so-called Windows 95 of smart cards.

In turn, such an operating system standard will greatly speed new application development, applications that will go well beyond payments in electronic cash.

From an industry perspective, the momentum to push smart cards forward in the U.S. is well underway. So, what does this all mean for Mondex?

Ultimately, Mondex introduces an extremely powerful new payment mechanism. It brings cash to the Internet. It eliminates fumbling for change in the cost of currency processing in the physical world.

In both environments, consumer access to cash reaches the epitome of convenience, an ATM in the home. When the multi-application operating system is introduced next year, Mondex will add a powerful platform that offers value added applications.

Loyalty programs, digital certificates, identification and applications not yet even conceived will move Mondex and other smart cards from "nice" to "have" to "must have" products.

1997 and 1998 will be lab years for Mondex in the United States. At this introductory stage of the Mondex product life cycle, no one has a crystal ball that can predict accurately the winning value proposition that will propel consumer or merchant acceptance.

Consequently, different organizations will test a wide array of propositions for consumers and merchants to learn what

works and what doesn't work before any type of massive national marketing effort-- begins.

For example, Chase Manhattan MasterCard will kick off the first large-scale physical world pilot of Mondex in the United States in the fourth quarter in the upper west side of New York City.

AT&T is already internally testing technical implications of Mondex payment on the Internet. Mondex will be evaluated as part of a financial institution's home banking proposition.

Tests in campus environments and co-branded pilots with large merchants are also critical for assessing long-term success. We must not forget that all players including Mondex are entering uncharted, highly uncertain waters.

The sooner more creative tests are conducted on card distribution, merchant acceptance and equipment to name a few, the greater likelihood the smart card product has of going ultimately successful.

As credit cards did 30 years ago and ATM cards did 20 years ago, Mondex is a breathtaking opportunity, an opportunity that can fundamentally change the way we live. How different would your life be without a credit card?

What if I took away your ATM card? Creating that same feeling of indispensability for Mondex signifies the challenge in the years ahead. Thank you very much.

CHAIRMAN LUDWIG: Thank you very much, Mr. Miller. Mr. Norwood.

MR. NORWOOD: Thank you. And it's a pleasure to be here this morning in front of this illustrious panel and to be able to give some information regarding what's happening in specifics with CyberMark.

Long story short and not a lot of background, basically I was originally attached to Florida State University for quite a number of years.

During the development of Florida State University, we developed what has been referred to in the industry as the FSU card combining banking, telephony, and other types of services within the campus including pre-paid value in what we refer to as junk stripe technology, i.e., the old copier card format, and took it much further than that over the period from 1987 to about 1993-1994.

During the 1993-1994 time frame, Florida State University was lucky enough to receive a grant from MCI, take that money and develop what was called later the card application technology center.

From the card application technology center, we were able to take mag stripe based card technologies much further into the higher education environment and take them to Florida State University's campus and explore all the possible benefits of that type of technology for cost reduction benefits and other things

within the campus.

During that development process, smart cards were always talked about, but never envisioned to be at Florida State University because of the cost.

During the 1994-1995 time period, costs started dropping. We received a large donation from several companies to help us move forward at Florida State University in the development of smart cards.

During that development cycle, we analyzed the benefits, pros and cons of smart cards, what they would do for our campus environment, and what they wouldn't do for it. The premise was that it would basically save infrastructure costs if it could do things other than simply stored value.

Stored value did not seem to be a triggering remark within our campus environment. We were able to do it with a card that cost 16 cents. So, why spend four, five, or six dollars a card to take over that activity?

Needless to say, we were very successful in doing that, successful to the standpoint that we were actually purchased. The card application technology center in a sense was privatized at Florida State University in March 1997 by a company called CyberMark.

CyberMark actually has a history from 1993 being formed by Sallie Mae Corporation in the research and development of smart card technologies in the industry and how it may benefit student loan programs and other types of activities to work around that.

In conjunction with CyberMark and the card application technology center, CyberMark has been able to take both the experiences at Florida State University, the previous R&D work done at CyberMark and expand those into a far reaching program today that we're taking across the country to other higher education institutions.

The program today is a true multi-application smart card based program that has been running at Florida State University since June of 1996. We have 36,000 cards issued, four purses, four loyalty programs.

V1 Internet security applications run in token authentication running with meal plans and other process underway as well. Those applications have worked extremely well for us to date.

We are processing in the neighborhood of almost 400,000 transactions a month through one of the stored value purses. We have had a total card failure of less than 100 cards in our almost nine months of operation to date, actual true failure of the chip within the card.

So, we've proven lots of things. Number one, students will certainly use this environment if it facilitates what they're doing.

The administration within the campus will certainly use

it if it facilitates what they're doing which is reducing cost associated with cash collection processes and other things that are critical to the campus environment.

We facilitated student services. Students today are beginning to access through the web using the V1 product, their transcripts, their grades, registering for courses and doing other things as well.

We're also currently pursuing payment over the net as well with the card. I guess in summing up this whole story to date, we have six campuses that are coming up this fall with the Florida State University model.

Each one of those campuses is reviewing it not based on the purse applications, but on the other applications that come with the card.

From a CyberMark perspective and also from a higher education perspective, one of the things we have been struggling with for many years was how to take this card, give it more value, and make it beneficial to the campus.

We think we've done that by basically blending the stored value or pre-paid value, as we like to refer to it within higher education, with the banking activities to take advantage of both of those.

At Florida State University today, we administer almost \$70,000,000 in student loans directly to the card through our banking partner which runs the card from that side called Suntrust.

The banking partner administers the funds, takes care of the distribution to the students, and allows them to pick them up through ATMs or directly through their DDA account.

In the very near future starting in August and September working with NorTel through their pay phones, students will be able to access their DDA accounts with Suntrust and transfer value directly to the purse within the card.

We have other development processes underway as well. We are now capable of issuing chip cards at other universities at a mass carding event in the capacity of 4,000 to 5,000 a day if need be.

We prime those cards over the Internet directly back to a single server based at CyberMark today and are able to initialize them at a low cost to the students and administration of the campus.

What does the future hold for this particular product? We're not sure, but it's exciting. It's fun. And we're constantly getting suggestions and new ideas from students, faculty, staff, and administrations within the campus on what they would like to do.

Starting July of this year, Florida State University in conjunction with CyberMark will take the FSU card off campus, and it will be given to the local community around us in Tallahassee.

We expect to distribute roughly in the neighborhood of

between 100 and 150 terminal devices that will allow those cards to be used within the merchant base around the city. With that said, we're trying to provide better service, cost-cutting revenues and opportunities to the campus as well.

With looking to the future, what does the card bring to us in the future? We don't have an answer for that. All we know is that it is exciting.

As the statements made earlier relative to the Internet, I think we've only seen the beginning. I think smart card with the price reduction that's occurring in the infrastructure cost everyday will simply allow us to do that.

The critical concern here for us is very basic. If this product is restricted to one particular organization at issuance, i.e., financial institutions, then the private sector will not be allowed to participate as much as it should be.

To date, we're allowed to play. We're having fun. And we're being very careful in the way we're administering what we're doing. And we're following all the rules and regulations that we can find regarding this particular product today.

We're inviting folks to come in, review what we're doing, tell us the right way to do it, and make sure that we follow and comply with the laws in the future. Thank you.

CHAIRMAN LUDWIG: Thank you very much, Mr. Norwood. I'm sure the audience feels, the panelists, and I feel that these were very illuminating comments and gives us a feeling for where business is. Thank you both. We turn to Mr. Smith.

MR. SMITH: Chairman Ludwig. Good morning. My name is Lamar Smith. I'm senior vice president at Visa, a Silicon Valley based corporation.

I'm delighted to be here today to talk about electronic money. Visa looks forward to contributing to the meeting today and continuing to work with you as you consider the issues raised by electronic money.

I will discuss this morning two of Visa's electronic money products that are today in the U.S. market, Visa cash and Visa TravelMoney. Visa has other initiatives in the remote banking and electronic commerce areas as well.

And we have played a major role in the development of standards that enable various types of electronic money products to be offered. These other initiatives are discussed in the written statement Visa has submitted.

And I'd be pleased to answer here today any questions you may have about these other initiatives. Now, onto Visa cash.

Visa cash is a pre-paid stored value card. The Visa cash card is embedded with a computer chip that stores electronic value data. Consumers use Visa cash as a substitute for currency or coins primarily for making small dollar purchases.

Visa cash cards are issued by our member financial institutions who are each obligated to settle card transactions for the cards they issue. On a worldwide basis, about 3.7

million Visa cash cards have been issued by over 60 Visa members.

About 15,000 terminals that accept Visa cash cards have been deployed. Almost two million Visa cash transactions worth about 8.5 million dollars have been completed.

In addition to the United States, which I will discuss in a moment, Visa cash pilots are ongoing in Argentina, Australia, Canada, Colombia, Hong Kong, New Zealand, and Spain.

Additional pilots have been announced for Brazil, Italy, Japan, and the United Kingdom. In the United States, the most significant experience to date with Visa cash occurred at last year's summer Olympic games.

Our bank partners, First Union, Nations Bank, and Wachovia produced more than 1.7 million Visa cash cards for use in this test. Between the opening and closing ceremonies of the Olympics, there were more than 200,000 Visa cash transactions worth about 1.1 million dollars.

Surveys conducted by Visa indicate a high degree of consumer satisfaction with Visa cash. For example, almost two-thirds of Visa cash card holders who used their cards during the Olympics found their transactions with the Visa cash card superior to cash transactions.

The only consistent consumer criticism from the Olympic test was that Visa cash was not accepted in more places. This criticism reflected the nature of our Olympic test.

Visa and our partner banks targeted a specific merchant profile for this test. Namely, our focus was on having the Visa cash card accepted at merchants located within the Atlanta metropolitan area with an average transaction value of less than \$10 and who operated predominantly in a cash environment.

Merchants meeting this criteria included mass transit, public telephones, quick service restaurants, convenience stores, and food concessions at Olympic sites.

The next significant test of Visa cash in the United States will be in New York later this year, which Mr. Miller referred to earlier. This test which will involve Citibank, Chase, Visa, and MasterCard is designed to test merchant terminals that accept both Visa cash and Mondex cards.

This is the first stored value card test of which Visa is aware that features interoperable merchant terminals. Based on our experience with Visa cash, we believe this product has the potential to benefit consumers, businesses, and other payments participants.

Consumers benefit from ease of use, convenience, and increased transaction speeds compared to cash or checks. As I indicated earlier, our studies have found that about two-thirds of Visa cash users prefer Visa cash to cash.

Visa cash also has the potential to make possible for the consumer new types of transactions such as purchases over the Internet. Businesses also benefit from Visa cash.

Their benefits include less pilferage, theft,

vandalism, and cash handling as well as faster transaction speed. Visa does not see any technological hurdles or security related barriers to full implementation of Visa cash.

The big question is whether notwithstanding the benefits I just described, a business case can be made to support the cost of installing a nationwide network of merchant terminals to accept Visa cash cards.

Capacity issues at some point further complicate this business case analysis. Now, we'll move to Visa TravelMoney.

Visa TravelMoney is a disposable, replaceable, pre-paid stored value card. As with Visa cash, Visa TravelMoney is issued by our member financial institutions.

Unlike Visa cash, Visa TravelMoney can only be used at ATMs. TravelMoney is designed for consumers to use during travel to withdraw local currency from any of the approximately 250,000 Visa ATMs worldwide.

Also unlike Visa cash, Visa TravelMoney is a mag stripe product and requires the use of a PIN to complete a transaction. Visa TravelMoney recently completed a successful pilot program in the United States and other countries and is now being launched on a worldwide basis.

As with Visa cash, our surveys indicate a high degree of consumer satisfaction with Visa TravelMoney. Since Visa TravelMoney utilizes the existing ATM system, we see no technological hurdles to full implementation of the product.

As for the future, it is impossible at this time for us, or we believe anyone else, to predict with any reasonable degree of certainty what will happen with electronic money.

For example, we do not know how important interoperability will be to the acceptance of these products or with the degree interoperability that can be achieved. The upcoming New York test should provide important information on these questions.

Given that electronic money is still in its early phase of development and no one knows what the future will hold, we believe any government regulation of these products at this time would be premature.

Premature regulation of electronic money could well have severe, unintended adverse consequences. I hope I will have the opportunity to address this concern in more detail later in the day. This concludes my testimony.

I will be pleased to answer any questions that you may have regarding my testimony here today or the written statement Visa previously submitted.

CHAIRMAN LUDWIG: Thank you, Mr. Smith. Mr. Weiner.

MR. WEINER: Thank you very much. Thank you for providing American Express with the opportunity to comment on industry developments to the distinguished members of this task force.

Since 1850, American Express has responded to the

marketplace's demands for innovative products and services, satisfying the needs of the public and the world traveler.

Our recent activities in the area of consumer electronic payments probably reaffirms this 146-year-old history of providing first-class innovative products and services to American Express customers.

Exactly one week ago at 3:32 in the morning on June 2nd, an American Express card member purchased a drill press from Walmart's web site using the newly published SET protocol.

This purchase represents the first U.S. Internet transaction in which actual goods were purchased using the more secure SET protocol.

Less than two weeks ago, on May 28th, American Express, Hilton Hotels, and IBM began public testing of the first implementation in the U.S. of multiple applications performed by the same chip on a smart card.

These American Express and Hilton branded smart cards are capable of performing charge and credit transactions, electronic airline ticketing, storing, viewing, and updating individualized travel profiles, tracking hotel stays, self-check in and check out at the hotel lobby kiosk, reviewing the card member's hotel bill, making car rental reservations, and loyalty applications.

Truly, American Express is living up to its professed aim of allowing its customers to do more. As exciting as these events are, they should be placed in their proper context.

Last year, American Express sold 26 billion dollars of its world renowned American Express travelers checks. That is a real business.

By contrast, the total sales volume of all three major reloadable offerings of smart card E-purses, Proton which we license, Visa cash, and Mondex, which their representative has just spoken, totaled 26 million dollars.

Thus, we are still in the early stages of this brave new world of consumer electronic commerce. A tremendous amount of work still needs to be done before the payment systems of the future become as ubiquitous as the consumer payment systems of today.

For American Express, this increasingly means working with others to make the consumer payment systems of the future a reality. Sometimes this means we will be working with our business partners such as Walmart, GTE, and Globe Set on our SET implementation pilot.

At other times, this will mean that we will be working with our competitors such as the work we are doing in the smart card industry with Visa and MasterCard in the interoperability group to demonstrate to the industry technical solutions so that a common point of sale device can be used to accommodate all payment card transactions.

In all of our efforts, our watch words are openness and

interoperability. And in this vein, I would like to quote from the keynote address of the fall Internet world '96 show by Lou Gersner, the chairman and CEO of IBM, and incidentally the former president of American Express who said, "Let us remind ourselves of how we got to this very exciting launching pad.

The Internet phenomenon that all of you helped to create results from one thing. And it's really not technology. It's agreements, agreements on standards.

So, one measure of leadership in this business has to be whether a company is working for open standards or working to erect proprietary walls, whether the company is working to ensure the true promise of any client to any server is being fulfilled, or is working to make it their client to their server.

A world populated by closed or semi-closed architectures forces the consumer to choose and then pray that they chose correctly. It takes away choice. And it may slow down or prevent the realization of a networked world all of us want to build for our customers."

Briefly turning to smart cards. First of all, what is a smart card? A smart card is one of these things, can be considered a computer on a card which is capable of performing both financial and non-financial functions.

Compared to mag stripe technology, smart cards are characterized by vastly greater data storage capacity, vastly improved data security, minimized fraud, and the possibility of card holder authentication.

On the other hand, the infrastructure of standards, interoperability for smart cards is still developing. My colleague from Visa has alluded to many of the smart card benefits, which I had prepared to discuss.

I won't discuss them in the interest of time. But with these manifold benefits that Mr. Smith alluded to, there are a number of obstacles to the expansion of smart cards in the U.S. including inertia, infrastructure conversion not only at the point of sale, but at the back end supporting systems.

But perhaps the greatest obstacle constitutes interoperability. The overwhelming majority of smart card pilots and launches are not usable outside of each specific program.

For example, the card holders of the much publicized Visa cash pilot at the Olympic games in Atlanta could not use their cards on Mondex or Proton based systems and vice versa.

In fact, Visa, Mondex, and Proton based smart cards are usable by card holders only in their own local implementations. Additionally, merchants are currently forced to have two settlement processes for smart cards.

One for credit, charge, and debit transactions, another for stored value transactions. Consumers and merchants are not going to tolerate this problem at the point of sale.

Consumers want their card to work anytime, anywhere, and for any function. Merchants want a single, inexpensive

terminal. A number of initiatives are underway to achieve some greater measure of interoperability.

They include in the communications area the global chip card alliance of which we are a member, in the terminal area of the interoperability group that I alluded to before, and the personal computer area, the PCSC work group, and for charge, debit, and credit functionality, the so-called EMV standard.

While these and other efforts are important, they fall short of what is necessary to create a truly open and global smart card infrastructure.

Some in the smart card industry including American Express have begun to recognize the need to undertake a broader, global effort to obtain the widespread acceptance, reliability, usefulness, and cost-effectiveness of smart cards.

Such an undertaking should seek to build, distribute, and support an open and global interoperable platform which permits multiple and diverse applications.

Such an undertaking would need to span the many industries and geographic regions that have an interest in developing and deploying smart card technology. For its part, American Express is working to develop a truly multi-functional smart card.

One such card might have the following applications. Corporate and personal travel profile, E-purse, automated car rental check in, electronic ticket or frequent flyer, automated hotel room check in and room access, Internet and LAN access control, loyalty programs, electronic coupons and vouchers, border control, charge and credit transactions, and corporate discounts and authorization profile.

We are currently developing core applications in the payment area, as well as the nonfinancial areas. In the area of stored value, as some of you may know, American Express signed an agreement to use the Proton e-purse for both electronic payment and electronic commerce applications.

We chose the Proton system because it supports the traditional American Express consumer value proposition. The Proton e-purse is completely auditable.

It has strong system integrity checking. It is scalable. The system is designed to support multiple issuers and multiple acquirers. And the Proton system is the market leader.

On page 22 of my written presentation, there's a chart which is taken from the April 26th edition of the Economist, which shows that Proton has 14 million reloadable cards issued.

Visa cash next with 1.6 million. Mondex with 100,000. That's on a worldwide basis. Turning to the area of charge and credit, American Express will be providing chip-enabled cards for charge and credit transactions as part of the British banking system's conversion of charge, debit, and credit systems to support chip-based technology.

We are currently also conducting a pilot with our

partners IBM and American Airlines for ticket list travel. The pilot enables the smart card holders to automatically board at 21 airports representing over 80 percent of American Airlines' domestic volume.

And of course, the hotel pilot that I alluded to earlier constituting the first public implementation in the U.S. of multiple applications performed by the same chip.

These and other American Express smart card products will better serve our customers, offer a rich complement of innovative and valuable products and services to our business partners and provide more profitable opportunities to our merchant network.

Turning very briefly to the Internet-based payment systems, there are four types of risks for card transactions over the Internet. The first being transaction risk which consists of the interception of messages.

The second being gateway risk which consists of the penetration of databases of the merchant or the financial institution. The third being fraudulent merchant risk.

And a fourth being fraudulent card member risk. Over the past few years, American Express has introduced a variety of solutions to mitigate or reduce these risks culminating in our historic implementation of the SET protocol last week.

First American Express introduced the SSL or so-called secure pipelines protocol to reduce transaction risk by creating a secure encrypted session or pipeline between the customer and the merchant.

However, the SSL protocol uses low-level encryption, provides the service establishment with card information, and poorly identifies the customer.

Next, American Express implemented an SSL gateway with appropriate firewalls to receive card transactions from the merchant over the Internet.

In implementing the SET protocol in last week's pilot, transaction risk and fraudulent merchant risk are reduced by the customer creating a secure encrypted envelope with card information which is encrypted at a higher level and which passes through the merchant without opening and is opened only by American Express.

These are so-called secure envelopes. The SET protocol further reduces fraudulent card member risk by requiring the card member customer to submit his or her digital signature certificate to both the merchant as well as American Express.

Implementing SET will require the creation and distribution of SET compliance software and its adoption by millions of individual customers.

The creation, distribution, and adoption of software and possibly hardware by merchants, the installation of SET gateways by financial institutions which we have done, and the issuance of digital signature certificates by financial

institutions to millions of card members and thousands of merchants.

Truly the task is daunting. But the consumer payment systems of the future will reward the consumer, the merchant, and the financial institution alike. Thank you very much.

CHAIRMAN LUDWIG: Thank you very much, Mr. Weiner. Thank you all for keeping your statements reasonably brief to give us time for questioning.

I'm interested in your consumer pilot experiences, that is, the degree to which there has been acceptance. How much acceptance, and where you are in the pilots?

In terms of a real roll out, what do you project in terms of volume and usage in two to five years, five to ten years? So, take us a little bit from the pilots how the consumers have reacted.

Where do you see the bumps in the road, if there are any? And where do you see things developing? Maybe if we go around the panel.

MR. MILLER: I think we can look at that in the Mondex environment in several ways. I mean, the first is to look at what's been happening at the international level.

And there have been pilots that have been running Mondex for the last several years. The first large-scale pilot occurred in a town called Swindon in the UK.

Very recently, a very large town scale pilot was started in a town called Gwelth up in Canada. And there are also some large pilots running in Hong Kong.

In the United States, Wells Fargo began its first pilot about a year and a half ago, a very small internal employee pilot. And that employee pilot was really designed to understand the technology much more so than either the consumer marketing proposition or the merchant marketing proposition.

With that said, the very first large-scale pilot will be this pilot on the upper west side of New York where approximately 50,000 card holders are targeted.

And as Mr. Smith mentioned earlier, the primary focus of that pilot is to test interoperability at the point of sale. With that said, where Mondex has been running around the world, clearly consumers embrace stored value and electronic cash for the reasons that Mr. Smith mentioned earlier.

Just the pure convenience of being able to eliminate your change and being able to get through transactions much more quickly provides tremendous, tremendous benefit.

And you're going to see those benefits only increase as the technology evolves. For example, when you start being able to get cash right from the comfort of your own home through either the telephone or the PC, it really starts becoming the next generation of banking where you no longer have to go to an ATM anymore.

You have 24-hour access to cash right from your own

home. And you're going to start seeing some of these new technologies being implemented in the New York City pilot and in other pilots that are going to occur.

In terms of some of the challenges that I see moving forward, I think we fit on some of the biggest ones which are both the infrastructure challenge, and with the infrastructure challenge particularly on the merchant side, I think what we all need to recognize is how do we do this cost-efficiently and very inexpensively?

Because the fact of the matter is when we look specifically at the stored value product, the economics in the stored value product are not like the same sort of economics that we see in the credit card environment or a debit card environment.

And so, that places an absolute premium on being able to exploit smart card technology in the fullest way that we can. And I think that's where you're going to start seeing some of the differentiating factors with some of the specific products.

For example, in the Mondex environment, we've been able to use the technology to essentially do offline, person-to-person transactions. Which if you then take that to the next level, it means that there really is no merchant clearing and settlement which then obviously means that the overall cost of the merchant over the long term is much smaller.

So, there are lots of things that we can do simply based on where the technology will take us. And at least in the United States, 1997 and 1998 are truly going to be years where we test a lot of these propositions.

Because sitting here today, none of us can say which one is actually going to drive either the consumers' acceptance of smart cards in general or which of these products is actually going to provide what merchants want.

It truly is going to need to be a case where we test lots of different things and see which ones work and which ones don't.

CHAIRMAN LUDWIG: Do you have a guess where you think we'll be in two to five years, five to ten years?

MR. MILLER: I think we're going to see real adoption more over the period between five and ten years. It's not like tomorrow we're going to mass issue the entire United States population with smart cards.

There are other things that are going to help drive that overall adoption in the U.S. Things like driving the credit card infrastructure -- and being able to have multi-applications on chips will certainly now make it much more enticing for consumers to have cards.

But I think you're really looking at massive penetration in the U.S. marketplace in the five to ten-year period rather than in a two to five-year period.

CHAIRMAN LUDWIG: And do you see any difference in that

regard in terms of the Internet versus non-Internet based transactions?

MR. MILLER: Yes. I think the interesting thing about that is the Internet, at least for stored value, could very heavily drive people's desire to have a card.

If you look at people who are heavily Internet focused, those are your technology savvy, your early adopters. Those sorts of folks are much more likely to be taking those cards in the short term.

And so, I think if we look at how quickly the Internet evolves in general, the Internet could in fact wind up driving much more quickly people's need to have a card.

Because in the Internet space, there is no electronic cash, where in the physical world, for the most part, cash does work fairly well, and people understand it and know it. And you have to build many greater benefits in the physical world than you potentially do in the Internet space.

CHAIRMAN LUDWIG: That's very helpful. Thank you. Mr. Norwood.

MR. NORWOOD: I guess sitting here is kind of interesting to listen because I don't think we're in a pilot at Florida State University. I have 35,000 real people running around with real cards everyday doing real business with them.

And that exceeded pilot about June 5th of last year. And at that point in time, I had the responsibility of making sure that their day-to-day activities are able to take place.

They're able to use their cards for purchases, cokes, snacks, washers, driers, postage stamp machines, coming up with the pay phones, and then the off-campus merchants.

So, the acceptance within that community has been extremely good. The numbers of problems have been almost non-existent, actually less than we had in the mag stripe world initially.

Where do we think it's going from here? We think that the adoption and the type of clientele we picked using it at Florida State University is the high-tech group. It is the people that are used to this technology.

It's the people that will do it. They play with it. They enjoy it. And you hand it to a student today, and they're immediately using it. I handed it to a faculty member, and he stood there looking, "Why should I play with this thing, and what do I want with it?"

So, there is a real difference in this. We think higher education will be a real testing ground for this market overall because universities are known for doing things out in front of the rest of the world.

And that's what's happening. Our business focus is universities now at CyberMark. As we said earlier, we have five colleges that are coming up with their cards individually.

Those five colleges are all linked together with us.

So, those cards will work on our campus. Our cards will work on their campus. So, when we say closed and opened systems, I'd like to say they are closed and semi-closed systems.

Will we ever be able to work with bank cards and will bank cards ever work in our environment? I think that will happen.

But it won't happen in the next few years because of the rules and regulations and the strictness with which financial institutions apply their disbursement processes and other things that make it rather binding for us.

Starting in mid-July or mid-June of this year to our incoming freshman class, we issue combo cards. And that's an interesting name. But basically what it's saying is that the FSU card is now combining a credit card to go with it.

It matches up in functionality and ultimately the chip will have encoded the credit card information within it within a very short future.

The functionality is primarily, folks, what the students and faculty and staff want. Many of our towns are driven by university environments. Columbia University in the middle of New York City doesn't have much impact.

Florida State University in the middle of Tallahassee, Florida has an impact with 35,000 card holders out of 200,000. We can implement and make things happen in that environment. I can't do it in a New York City environment. Thank you.

CHAIRMAN LUDWIG: Professor Smith, you did give us a picture of some of the pilots. Do you want to add to what you've said and perhaps give us some time frames?

MR. SMITH: Well, let me elaborate just a little bit. I mentioned two different stored value products that Visa has in the marketplace today.

One is Visa cash. And the other is TravelMoney. And looking at those two I think gives you some distinctions that need to be kept in mind as you look at where all this is headed.

Visa cash has thus far proven itself to be very popular with consumers and with the businesses that use the product. The big unknown right now is the business case.

Can this be a product that can be profitably brought to the market? And we don't know the answer to that right now. So, we're looking at technology and such as interoperable terminals in the New York pilot.

And we're looking at the business case for the product. TravelMoney is a product about which we are far more convinced on the business case side. It is being rolled out as we speak.

It is very successful around the world. And we anticipate it being very successful in the U.S. And what is the future? Well, Glenn I think mentioned the volume of traveler's checks being sold.

And that's what we intend to capture with the TravelMoney product. Comparing the two, there are two

distinctions I would keep in mind.

Number one is that stored value is not synonymous with smart card. A smart card is a card that uses a computer chip rather than a magnetic strip. Visa cash is a smart card based stored value product.

Visa TravelMoney is a mag stripe based stored value product. So, you can have the two different technologies being used in stored value products.

Clearly, as I indicated, the business case for a mag stripe product is stronger right now. Another distinction that I would urge you to remember is that electronic commerce is not synonymous with either smart cards or stored value.

The SET protocols have been mentioned by several speakers here. The SET protocols basically are standards to be used by software writers so that they write software so two different software products can talk to one another.

An SET implementation may very well involve use of a mag stripe credit card or debit card to make payments over the Internet. You don't necessarily need a smart card.

You don't necessarily need a stored value product to use SET to make a payment over the Internet. In fact, where Visa is right now, we're looking at using SET to make payments over the Internet using credit or debit cards for your larger value payments, say over \$10.

And the stored value product may be most useful for those smaller dollar or microtransactions over the Internet where you cannot justify the full cost of a credit card or debit card transaction.

And by that I mean, if you use SET to make a payment with a credit card over the Internet, you're using SET to get the purchase information to the merchant and the payment information to the merchant's bank.

But once that payment information gets to the merchant's bank, it gets entered into the existing credit card authorization and clearing and settlement networks. That is an important distinction.

And one thing that will determine the growth of these products will be what type of commerce evolves on the net. If it's a series of microtransactions buying very inexpensive pieces of information or whatever, that's going to give impetus to the stored value and to the smart card.

If it's more higher value transactions buying shirts and whatever, that does not necessarily need a stored value or any micropayment. It may very well be done with SET implementing the existing credit card and debit card payment. There are lots of imponderables here right now.

MR. WEINER: I think a point that Mr. Smith made is very true, which is most companies employ whatever technology that serves the perceived needs of their customers.

And whether it's mag stripe or whether it's chip-based,

what they want to do is satisfy those customers' needs and then choose the technology based upon it. And that's why there are distinctions between say the mag stripe and chip-based stored value and the Internet as well.

But to directly answer your question, I think what you'll see on the smart card side, page 18 of my presentation I've gone out on a limb and actually laid it out for at least our best guess looking into the crystal ball on the smart card side.

And it basically breaks it down into three periods, from the present to 1998; from 1998 to the year 2001; and beyond 2001. And that's our best guess. It's an educated guess.

I think what you'll see in the near term is companies that are introducing smart cards doing two things. One, testing technology. And two, as Mr. Smith alluded to, testing business cases.

And I have to agree with the thrust of the comments Mr. Norwood was making. We very definitely are of the opinion that the future of smart cards are multi-functional smart card, that stored value alone is not enough.

And I think what you're beginning to see in the industry is a convergence of opinion on that with the recent announcement by Mondex of their multi-operating system and multi-application.

A couple of months earlier than that Visa made an announcement about their endorsement of Java for multi-application. And as I've alluded to, we're already in the market piloting multi-application cards.

So, it's going to be a question of (1) making sure that the technology works and (2) testing the business case. And it's going to be fiddling around with different applications to see what adds the most value to the customers and where you can demonstrate value.

Another point that needs to be made, and again it's sort of piggy backing and expanding upon some of the comments that Mr. Norwood made, I think what you'll see is that we'll move from closed to semi-closed to semi-open to open systems.

The advantage to doing something in a closed system is greater control, and you can examine what's going on more carefully. And I think that as smart card issuers begin to get better sense as to what they're doing, it's going to move out into the marketplace along that path.

With respect to the Internet, I'll be the first person to tell you I am not an expert. But when I asked my colleague on Friday, because I anticipated your question, what he asked me to communicate was nobody knows for sure on the Internet.

We, American Express, will be ready in the fall of this year. But broad usage of it is very much dependent upon a number of factors. And I think all of us would agree, we're really dealing in uncharted territory here.

First, it's having user-friendly, interoperable

software. The second is the software being adopted by the consumer. And the third is the issuance of digital signature certificates to the consumer.

CHAIRMAN LUDWIG: I have a number of other questions myself. But before I do that, why don't I ask other task force members to see if they have any questions at this stage. If not, I'll ask what I have. Anyone else?

MR. HOVE: Let me talk about a couple of things. Lamar, you talk about the Visa TravelMoney. And obviously that's a lot more money embedded in the card than the Visa card that you used in the Olympics.

Tell me the process if someone loses a card and how do they recover their money? What are the risks for the consumer?

MR. SMITH: In the TravelMoney product?

MR. HOVE: Yes.

MR. SMITH: You're correct. The TravelMoney product involves a much higher value typically. The Visa cash cards that were used in Atlanta the maximum value that you could put on the card was \$100.

The TravelMoney product, I believe the average value is close to \$1500. It is significantly different from the Visa cash. Number one, it is an online system.

Number two, it involves the use of a PIN, personal identification number. So, if I go and I buy a Visa TravelMoney card, it's designed principally for someone who's going to be traveling, especially traveling abroad.

And I use that card in an ATM machine. There is an authorization and a clearing and settlement message that goes through online. I have to identify myself with the personal identification number.

If the product is lost, it is fully replaceable. And the card holder will be given a telephone number to call, a toll free number, to get a replacement card. So, it is relatively low risk to the consumer. And it's a fully replaceable product.

MR. HOVE: I would ask the same question to Bill Norwood. How do you handle a lost card at Florida State?

MR. NORWOOD: Florida State University has a set of rules how they handle things internally because they're a university. CyberMark is reviewing in conjunction with some of the people in this panel as well on what the rules and regulations need to be.

Because I guess we are rather a unique duck in this organization because we're not a financial institution. Basically, purse one has a \$99.99 limit on it which falls under your rules and regulations regarding that.

It operates as a non-PIN and PIN-based application, i.e., if I use it on a coke, snack, washer, dryer, PINs are not required. If I go to any of the intended point of sales where it's accepted, PIN is required.

So, a certain portion of the value is protected within

that purse. The purse has a \$20 spend limit set on it. So, that basically in the unattended activity world, I can spend up to \$20 without having to have a PIN verified.

And after that, it does ask for a PIN verification. So, basically, at some point, you have to go back and say, "I still am the owner of this card. Here's my PIN to go with this particular chip. And, therefore, let me continue to spend out of this purse."

So, therefore, we protect up to \$20. The consumer is liable in a sense for up to \$20 in loss on that chip. And we can validate whether that has ever been used or not and replace it.

And we hot list the cards. We can actually zero them out. So, we can take care of the consumer. Purses two and three today are new development purses for us.

One is called a bookstore account and the other is general meals. The bookstore account today, we're trying to set up at a \$2,000 limit in conjunction with the bookstore.

Purse two is always PIN-based and is only used in three or four locations, specifically those selling academic or textbook-based type materials.

Purse three is meals, which would be a general use meals purse and has \$1,000 limit on it and will be, again, all PIN-based applications and would be used in all of those places where they take place as well. So, those are the three and actual in-use purses today within our card.

Purse four, we haven't found a use for it yet. It's just sitting there waiting.

COMMISSIONER MORRIS: I'm still struggling to understand this business right here. Maybe you are too. But I'm puzzled. What is the source of return on investment?

I hear you saying that the jury's still out on that. But are we looking at if I were an investor in this market, would I be looking at fee income from the users or from retailers?

Or would I be looking at float income or cost savings from transaction costs or risk reduction from better identification procedures? Where would I look for my income stream or my savings stream? Can you help me a little here?

MR. MILLER: Sure. On the stored value side, what I would say is go back and think about the analogy for cash right now. And so, essentially what I think all of us are trying to do is to create a much more efficient mechanism for dealing with a cash-like product.

And so, right now, if you take it from the retailer's perspective, retailers right now employ cash management services to actually get their cash into the bank.

And so, certainly from a financial institution perspective if we can make that process much more efficient and eliminate much of the paper handling process which is tremendously, tremendously expensive to retailers right now, that offers tremendous value to retailers.

On the consumer side, again we need to go back to the convenience of cash. We all know right now that consumers are very much willing to pay for the convenience of cash access.

And what we need to do is just look at what consumers are willing to pay for foreign ATMs. And this is really what we consider to be the next generation of banking in that now you don't have to go to the ATM.

You can get even greater convenience by getting cash at home. And we believe that consumers will be willing to pay for part of that access, more convenient access to cash.

So, certainly from the stored value perspective I think the analogy is cash. I think as mentioned earlier, we're all embracing the idea that ultimately smart cards are going to have many more functionalities than simply stored value.

And we believe there are tremendous opportunities for financial institutions based on their relationships, very strong relationships, with both customers as well as retailers to really understand what those customers and retailers truly want and be very much a part of delivering some of those new applications and solutions.

MR. SMITH: I would say from the perspective of the issuer of the product, let's start with the TravelMoney, which is the stored value, electronic traveler's check.

Traveler's checks over time have proven to be a very profitable business for the sellers of the checks. One way to look at it is I as a consumer am paying the bank to be able to invest my money and keep the interest income on that investment.

That's a good deal for the seller of the traveler's checks. The TravelMoney product basically gives all the same advantages to the seller of the product.

The bank that is selling the TravelMoney product to its customers holds the funds until the money is withdrawn. So, another way to look at that is to say it avoids a cash drain from the bank over that period of time before the card holder actually uses the card.

A similar analogy can be drawn with Visa cash. I mean, it does avoid or delay a cash drain or the loss of reserves from the clearing transaction from the bank selling the card.

That being said, you know, the pricing of these products is still unknown. The way the Visa system works is that Visa designs a product that the members of Visa around the world can choose or not choose to issue to their customers.

And each of those institutions prices it as it sees fit. So, the various institutions will be competing with one another in this marketplace in determining how the pricing works.

And the pricing may be all over the lot. Depending upon the advantages to the merchant, the merchant may pay part of the price. Depending upon the advantages to the consumer, the consumer may be willing to pay something for it.

It may be a vehicle for advertising, putting someone's

logo on a stored value card. This has been thought of. So, there are a myriad of options out there.

And clearly, the final answer has not been determined. And my guess is just as with the Visa credit card product, different institutions will price differently. We have cases where some have annual fees, some don't.

Some have enhancements such as frequent flyer miles, some don't. Some give cash rebates, some don't. So, my guess is that the consumer will have a wide variety of choices just as he does in the credit card product today.

MR. WEINER: Just two observations. And it's a point that you made in your question. As we all sort of articulated, nobody's really been able to demonstrate, at least in the U.S., a clear business case.

But there are two aspects to it. One is the expense reduction. If you look on page 13 of my presentation, it shows the experience of the French banks in the introduction of smart cards in relation to those banks that continue to issue cards mag striped.

And what you'll see essentially is that the banks that adopted smart cards, their fraud rate went from a little over 16 basis points to just over two basis points within the span of about six years. It's somewhat like a ski slope.

On the other hand, the banks that continued to use just mag stripe were on the chairlift on the way up. And they went from about ten basis points to about 20 basis points.

So, clearly that is one element of a potential business case. There will be some additional -- you obviously have to look at it on the revenue side. And I think what you're hearing from all of us is that how it's priced it's too early to tell.

But the one thing again I would just encourage you to keep in mind is the fact that these cards both have financial as well as non-financial functions.

And as a result of that, you're dealing with ways of looking at things that are not purely financial. Float might be part of it, but there may be other things as well. You're dealing with information which could be useful and have value as well.

MS. BERNSTEIN: I had a question for Mr. Norwood. Mr. Norwood, do you think your system, which I understand to be an expanding one to other campus universes, is dependent on its being a closed system?

That is, if one of these, for example, a Visa card or one of the others wanted to enter that environment to compete with your system on Florida State, for example, would that be feasible? Would it be a problem? Is it workable?

MR. NORWOOD: Workable, feasible, and possible are really three distinct answers.

MS. BERNSTEIN: Yes, three distinct questions.

MR. NORWOOD: Technology-wise, yes. The readers we're

deploying today for our unattended type devices have three SAM slots in them which, if we can all cooperate together and if we can work together, ultimately means their cards could work in our readers.

But typically, what we run into is the restrictions being placed in EMV and other things make it awfully difficult for some of these other non-financial institution products to work with them.

So, it's going to be difficult to do that. Not impossible, but difficult. Will it be affordable to do that? I think the answer to that is, yes.

I think the ultimate answer here is that we will have an installed base in certain areas that will be much larger than theirs initially. Then they will want to come into those areas and work with us to further the development, the deployment of stored or pre-paid values.

And that opportunity will be there to do that. So, I would say, yes, it will work together. And, no, we will not end up with the merchant hopefully being stuck with a two to three-year solution that they ultimately have to replace again.

And more importantly, we hope that the university will not be stuck with a smart card-based solution that they have to redeploy in three to five years out as well.

So, there are lots of things happening that can impact that. And I think you folks sitting up here can have a bigger impact than any of us had dreamed. But we'll wait and see.

CHAIRMAN LUDWIG: Governor Kelley?

GOVERNOR KELLEY: Yes. Shifting the focus a little bit to regulation, several members of the panel had mentioned that with the industry in its infancy and developments of many kinds going on, it would be premature to try to do any regulatory activity.

But we all know that down the line, it's possible that some needs will be clear, maybe fairly soon, abuses, consumer protection information. I just wonder from the standpoint of this group and your part in this activity, are there any regulatory areas where the absence of regulatory clarity is itself inhibiting developments?

For instance, the uncertainty about Reg E, that one or maybe some other areas where further clarity would be helpful.

MR. MILLER: I can say, at least from our perspective, none immediately come to mind. Because most of the time, an effort is really being spent, as has been mentioned earlier, on really figuring out commercially what needs to be done to actually make this happen.

And we've at least taken the perspective to stay very close to the various regulatory agencies who are involved to make sure they're very clear on what our direction is. And as well for us to keep abreast of what your potential direction is.

But I can't think of any immediately that come to mind

that are actually inhibiting our ability to move forward.

MR. SMITH: I would agree with what Mr. Miller said, Governor Kelley. As you know, we have been briefing your staff at the board as well as the staff of the OCC and the FDIC and elsewhere on everything we're doing.

And we do not see any impediments to testing the business case and the functionality of these products at this time. We certainly do endorse the regulatory agencies keeping a close watch on what's going on and helping us identify potential problems out there.

But right now, this product is truly in its infancy. No one knows what technology is going to win the day at the end.

And we sense that there is greater risk that regulation at this time will have a perverse impact on technology selection. The downside is much greater than the upside.

MR. WEINER: I would just add two very minor observations. One, we were gratified by the position that the Fed took on Reg E recently.

The second is that we're watching very carefully the proposed regulations that the Commerce Department is issuing on export controls of encryption technology. Encryption technology is an enabling technology for all of the computer-based products that we've been talking about this morning.

We've been gratified thus far by the position of the Commerce Department. We're looking forward to looking at the regs that are due to come out in the near future.

MR. OLIVER: I was interested in your comments on infrastructure and interoperability because ultimately, we hear a lot from people that they're confronted today with having to decide between investment choices in new electronic systems.

We talked about the card reader being capable of handling three different cards and those types of things and the standards on chips. But that has to be back ended to communication systems, authentication systems, and things like that, all of which today I assume are proprietary to your needs.

Are there efforts going on to look at sharing behind the card reader and is that the type of investment that's likely to lead to more of the interchange fees and other things we see on other shared systems?

MR. WEINER: When you're talking about interoperability, really you're talking about, as your question correctly assumes, at many different levels.

First, you're talking about at the operating system level. Then you're talking about at the application level.

And when you have multiple applications on the same card, the relationship between those applications so that one application doesn't crash the next one, then you're talking about interoperability between the card and the card acceptance device.

Then you're talking about interoperability, the switch. And then you're talking about interoperability at some sort of

clearing and settlement function.

It's very complicated. And really the thing that's going to drive the more rapid deployment of this is the sooner the industry comes together and agrees upon open and interoperable systems, decisions at each of those levels, more likely it is that the sooner you'll start seeing this in the hands of more and more consumers.

And as I alluded to, there are a number of efforts that are under way at the PC area, at the terminal area, EMV which is charge, credit, debit, and in the telephone area.

But in all honesty, all those efforts fall far short of what really needs to be done. And I think if everybody recognized that and actually puts some resources to it, I think you'd see a much more rapid acceptance of this technology.

MR. MILLER: I would just like to follow up just briefly on that and absolutely agree with those comments. And I think one area where you're beginning to see a lot of momentum is in the Internet space.

Because clearly, there needs to be some common standards both as far as just, for example, how the whole trading and customer experience process works. And we're all very use in the physical world.

We know how we deal with the merchant. That all is starting to evolve in the Internet space. And you're beginning to see some of the major technology companies come together all the way from the beginning of creating consumer wallet software to all of the back end systems that interact with the financial institutions.

You've got major players. For example, companies like Verifone and Microsoft and those sorts of players all coming together recognizing that they do need to set some standards and create this sort of interoperability with existing systems if this is ever going to get off the ground.

MS. BUCK: Whatever role the government eventually might take in trying to regulate this form of delivery of cash or monetary value to individuals, do you think there's any lessons we've learned from comparing the regulatory structure that's there in the United Kingdom or what you were talking about, Mr. Norwood, about you're not a bank so you're not governed by the same restrictions that apply to banks?

There might have been something either in your experiences that either advance or retard the acceptance or the ability of you to expand the use of this technology?

MR. MILLER: I would say from the Mondex experience it's been the case that many of the regulatory agencies around the world have been raising the same issues.

So, there's some comfort in that, that we all recognize what the key issues are, whether we're talking about privacy issues, whether we're talking about how regulators are going to actually regulate the specific products.

Again, I can't think of any specific example from any individual country that has either retarded or enhanced what we're doing because I think everyone recognizes, at least where stored value is concerned, the same set of issues.

MR. NORWOOD: I guess in two cents or less here, the universities for many years have been kind of bouncing around this Reg E issue with what we call closed systems and funds received from mom and dad dedicated specific purposes within the university campus.

And I think under your kindness you have allowed us to continue to do some of the things that have let us advance our technologies in a sense to do those things, the meal plans and the other things we have been doing.

Some of those have pushed the limits by extending them off campus electronically and hooking up merchants off campus electronically and doing those things. And again, you have not come down necessarily on those folks just to ask a few questions occasionally which has caused a drawback immediately.

But universities are really a pushing breed. They want to continue to do things, but they also want to continue to generate revenue and provide services.

The rules and regulations in our particular area to us appear to be very unclear at times regarding some of these types of activities, i.e., definitions. Banks continually use the term stored value.

We continually use the term pre-paid value. And to us, that's two significantly different things. And we work very hard at doing that because we know that one has regulatory implications beyond the other we think.

But we don't know that for sure. So, that's why I personally, from our company's perspective, was very anxious to work with you to define exactly what are we as an independent. Because we're not a financial institution, today.

And we want to be able to do business in this arena. And we want to be able to grow and develop products and technologies. But typically, sometimes the mindsets around EFI stop us from doing that.

CHAIRMAN LUDWIG: Well, we're just about at the end of our first panel to give us industry's view in terms of what's happening which has been very, very illuminating. We're going to move in our next panel to disclosure and consumer protection.

But before we completely wind up, I wanted to ask one final question. Mr. Smith will be on the next panel, so he need not answer. I can get to him later.

In terms of industry's perspective for the rest of you that there are benefits, and you illuminated a number of them, are there also risks for the consumer?

You said you don't think there's a need for, although with some definitional differences from Mr. Norwood, government rules and regulations at this moment.

What are you doing in terms of these systems that are a pilot for the rest of you, other than Mr. Norwood's system, to protect the consumer? What are the consumer protection things that you're doing yourselves?

MR. MILLER: I think there are a number of different ways to answer that question. I mean, certainly from the technology perspective, I think we all agree that the worst case scenario in this evolving industry are for consumers to have just a terrible experience with any of the pilots.

And so, I think a lot of effort has been put into making sure that the fundamental technology actually works. And whether we're talking about Mondex or Proton or Visa cash, the basic technology works.

So, from that perspective, at least we're getting off to the right start and setting the right expectation. But then, I think we need to go into some of the deeper issues.

And we're taking a very proactive approach where, for example, privacy is concerned because we know that being able to use a smart card to potentially capture information has lots and lots of implications.

And so, starting right now to understand what actually our privacy policy should be and where it makes sense to have things like loyalty programs and where it makes sense to capture centrally certain types of information, those are the things that we're doing right now to really understand from the consumer's perspective what they really embrace and what they don't embrace and to make sure that in the end game, our technology is flexible enough to accommodate truly what the consumers and retailers actually need in their products and what their concerns are.

MR. WEINER: A couple of points. One is much of the work that we've done has been corporations rather than with individual consumers. So, sometimes the issues are not quite as heightened.

But among the things that we do is we write very, very clear card holder agreements and try to provide education. In addition to that, because of our long-standing history in the pre-paid or stored value, depending upon which term you want to use, area, we hold all the funds that are given to us.

We cover that as a permissible investment, irrespective of whether or not it would actually fall within some of the money transmitter laws.

And we treat that as a permissible investment and keep it within the very conservatively defined investments an institution such as ours would use for those funds that are otherwise regulated.

MR. NORWOOD: From our perspective to date, our funds pools management has been handled by the universities to date. We are reviewing business cases to change that, but again, we're not sure what the regulatory issues in doing that.

But today, they're handled in the university campus.

And they stand behind that with all the university rules and regulations be they public or private that apply to those funds pools. So, they're handled within the university today.

CHAIRMAN LUDWIG: Thank you. I'm sure we could go on and on. I know I've kept us a few minutes late. These have been very, very helpful comments. We have looked at your written materials carefully.

If any of the members want to follow up with written questions, I'm sure our panelists will be pleased to answer them. Thank you very much.

CHAIRMAN LUDWIG: For our second panel, we're fortunate to have a number of distinguished panelists.

Let me introduce them. And then, we'll call on them perhaps using the same order we did this morning. With us in the second panel is Mark Budnitz, Professor of Law from Georgia State College of Law.

Mark Plotkin from Covington & Burling is here on behalf of Mondex USA. Judy Rinearson is Group Counsel for American Express; Margot Saunders is Managing Attorney for the National Consumer Law Center.

And then Lamar Smith as I mentioned in the first panel is back with us. Lamar is Senior Vice President for government relations at Visa. Why don't we start with you Professor Budnitz?

MR. BUDNITZ: Good morning. Thank you for asking us here this morning. My name is Mark Budnitz. I'm a Professor of Law at Georgia State University College of Law.

And I will be testifying here with Margot Saunders. I will be presenting the results of a study that I conducted. And as a result of the study, I had some concerns about the consumer protection implications of stored value cards.

And after I make my presentation, then Margot Saunders will talk about a model act that we drafted to provide a concrete example on how some of these concerns could be met.

In conducting my study, I looked at the proposed regulations and guidelines and so forth that have been set forth by the OCC and the FDIC and the Fed. And I looked at an American Bar Association task force and other sources of information that I could gather.

I also examined the marketing effort that was made by Visa and three major banks in Atlanta during the Olympics. Since I'm based in Atlanta, this was a convenient thing for me to do.

I found the following. Number one, the financial responsibility and soundness of issuers of pre-paid phone cards is of great concern. Several of them have gone out of business leaving thousands of holders of pre-paid phone cards with worthless cards.

Also, there are reports that the Mafia has infiltrated this business. This raises the concern obviously about the

reliability of a payment system where you have these elements present.

And, of course, the question also is whether there is the possibility of these kinds of problems with issuers when you look at other types of stored value cards.

And so, in our proposed model act, we seek to have a provision to protect consumers so that they will not face the uncertainty of the solvency and reliability of the issuer.

A former vice chair of the Fed and this ABA task force pointed out the problem of finality and discharge of obligation when you use a stored value card. And it's related to the first problem, the insolvency or unreliability of the issuer.

What if the consumer buys the card, then goes to a store to pay for the goods, and the merchant cannot get credit? Can the merchant then go back to the consumer and say, "Pay up."?

The consumer says, "I already paid. I bought the card. Then I used it and had the value deducted from my card when I bought those goods from you." The merchant says, "Well, I didn't get paid anything. The issuer would not honor it."

Does the consumer have to pay twice? We need law. We need clear law. This is not just to benefit the consumer. This also benefits the other parties, the business side so that they will know what the law is.

They will know who has liability, upon whom loss will rest. Merchants need these answers. This relates to what Mr. Ludwig was saying earlier this morning.

Are there some areas where it would be beneficial to have clarity in the law? Sure there would be. These two issues define financial soundness of issuers and whether payment by stored value card discharges obligations starkly demonstrate that there's a great deal at stake here.

And again, in terms of discharge, our proposed bill which Ms. Saunders will be talking about in just a couple of minutes seeks to provide some protection to consumers in this regard.

Mr. Miller, a few minutes ago, said what he wants to accomplish. What his company naturally wants to accomplish is for consumers to feel that possession of a Mondex card, or we can broaden it to any kind of stored value card, in his words, "They will develop a feeling of indispensability."

I have to have this card. This is a must have payment device. Well, sure. And if I were representing one of these companies, I would have the same attitude naturally.

That's what you want to do. That's what you want to accomplish. But that is what they're going to try to have consumers' attitude being. This is something I have to have.

And the students at FSU and other colleges, they also are in a system where the use of these cards is really something that is a must have payment device.

Number three, fees. My study looked at the terms and

conditions imposed by the three banks selling stored value cards during the Olympics. All three had very minimal disclosures on the cards.

A customer service number, and if the card is lost or stolen, the customer is stuck with that loss, and an expiration date. And that is basically all the information that was given on the cards.

Only one bank where I bought the card provided me with information about fees. And it said that if I wanted to redeem the unused value, it would cost me \$3 to redeem the value.

There was no other information about fees which raises the question, "Were the banks, or Visa imposing, other fees, and they just weren't telling me?" Or maybe there just were no other fees.

Our bill would require disclosures in terms of fees. Redemption. Two cards told me nothing about whether unused value could be redeemed. I don't know if that means I could or if that means I could not redeem the value.

This one bank not only had some disclosures on the card, but also one bank gave me a card agreement. And this card agreement imposed a \$3 charge for redemption.

So, yes, I did have the redemption rate. If there was less than \$3 on the card of unredeemed value, then I did not have a right to redeem. Our bill would clarify just what the redemption provisions would be that the consumer would be subject to.

Change in terms. This one bank that gave me an actual agreement which was in a brochure said, "This agreement is subject to amendment at any time without prior notice and is governed by Virginia and Federal law." Virginia law.

As we heard this morning, these cards were marketed during the Olympics so that they could be used by stores in Atlanta. So, why Virginia was chosen as the applicable state law is a question that I have.

But more importantly, this agreement was not really an agreement at all because, as I just read, it could be changed at any time by the bank without any notice or agreement by the consumer. Our bill seeks to deal with that situation.

Number six, liability for loss of funds. As I said, if the card was lost or stolen, the card themselves had the disclosure that the customer was just going to be stuck with that loss.

But what if there was a loss of funds due, for example, to a damaged card? Then, who suffers the loss? Nothing was said about this on the cards or in the card agreement.

Error resolution. Three cards gave me a customer service number, but nothing was said about whether there was any error resolution procedure.

Advertising. The advertising said this card was better than cash, that the cards are cash equivalents only superior to

cash. No mention of the fact that unlike cash the cards are not legal tender.

There's the risk of insolvency of the issuer. There's limited or no redemption. There are expiration dates. And also, the ads confuse the differences between these cards and other payment systems.

Very quickly, privacy. There was no provisions at all about privacy rates. Ten, as I said, the disclosures were very limited, expiration date, customer service number if card is lost or stolen.

Finally, there was no provision for a right to the transaction history. Because of these concerns, Ms. Saunders and I drafted a bill which she will now describe to you.

CHAIRMAN LUDWIG: Thank you very much, Professor Budnitz. Ms. Saunders.

MS. SAUNDERS: Thank you very much for inviting me here today. I represent low-income consumers particularly. And we have a very strong interest in seeing a basic overlay of protection.

Basically, because while we believe that as this new product or products develop in the marketplace, the industry will make it very likely, will make the products such that there will be adequate consumer protections and disclosures so that we'll all buy them.

Most of these concerns will probably be addressed initially in the marketplace. But eventually, if in fact the use of stored value cards becomes absolutely indispensable to transactions in the marketplace, low-income people will be forced to buy them.

And as we've seen in the low-income community, the marketplace does not work in poor areas to provide protections to poor people.

We know from our experiences with check cashers, rent to own dealers, finance companies, even high rate lenders in the mortgage area that where consumers may be protected by competition in the marketplace in middle income areas, they are clearly not in low-income areas.

Professor Budnitz and I, looking at all of these questions and having heard many of the concerns about how can we regulate a developing industry, thought we'd come up with what we thought to be a fairly light overlay of regulation.

We know that the industry is not going to like this. But we don't expect them to. We'd like to persuade you that something along these lines, however, would be appropriate.

I'll go through it very briefly. And as I do, I ask you to keep in mind although I'm going to be saying this would be prohibited and that would be prohibited, what I'm not addressing are all the vast areas that we are not prohibiting.

Essentially, we would start out with a stored value card protection act that would apply to all multi-purpose cards

whether they were in closed systems or open systems of any value and all cards that were for single purpose for over \$25.

We would require that all issuers were either regulated for the safety and soundness by the federal government or bonded in an amount equal to twice the value of the sales of the stored value cards in one year.

Now, everybody sitting on this panel that we've heard from today probably clearly have no reason to be bonded. We have no reason to expect American Express to go under at any time.

But if ABC check casher begins to issue these store value cards, I hope you see the need for some kind of protection in that way.

Final payment, flat prohibition or flat statement. Payment for goods or services by a stored value card constitutes full and final payment by the consumer.

We would propose no limit on the fees for the card, for the devices, for any other accoutrements that are attached, no limit on fees for the reloading of the card except what was agreed to between the consumer and the provider.

So, that when you bought a card and perhaps it had a very expensive wallet and other transactive necessary accoutrements, you know what your future costs will be.

We do put a limit of a dollar on your ability to redeem. We think you should always -- American Express traveler's checks doesn't cost you anything to get your money out. And you should always be able to go get your money off of the card.

It's your money. You already paid what it costs to get the card. And we think there should be a very long time limit on the period within which you have to redeem the money on the card.

However, there's no limit whatsoever that the issuer could place on how long the card is valid to use in the marketplace. Three months, three years, whatever.

But that's a very different limitation than the amount of time that the consumer has to get his or her own money off of it.

Change in terms. Either you don't change your terms during the validity of the card, or you keep the name and address of the people to whom you sold the card and you send them a notice saying, "Here's the card. Here are our change in terms."

And you have the ability with that one dollar fee if you don't like it to turn your card in and get your money off.

Liability for loss of funds. Among consumers, this is an issue of tremendous importance. And I think the industry, we believe the industry is so scared of regulation because of the liability for loss of funds that we see in the electronic funds transfer act.

We tried to very carefully tailor the liability for loss of funds to what actually could happen and what is in fact reasonable.

We say the issuer must provide consumer with reimbursement when there's an error attributable to the issuer or the merchant's defective device, when there's fraud or mistake on the part of the issuer or the merchant, when there's damage to the stored value cards and the funds remaining on the card itself can be determined, when there's theft from the device as a result of computer hacking or some such similar occurrence, or any other cause when two things occur.

One, the issuer can determine how much money is left, and two, they can stop that money from being accessed. We propose a fairly simple error resolution procedure that puts the onus on the consumer to come forward. And then, when he's shown something, the issuer would respond.

Prohibitions. Issuers can't make false and misleading claims. Issuers cannot provide personal information about the use of the card to third parties without the express permission of the consumer.

Disclosures. We don't think they're too onerous. When you initially get the stored value card, you get a brochure setting out information about what your fees are, what the error resolution procedures are, what your rights to reimbursement when you lose the funds, and how long the card lasts.

On the stored value card itself, there should be the name of the issuer, the date of issuance, the expiration, and the name and telephone number of the issuer to whom one should go for error resolution.

Disclosures at the transaction. For transactions over \$5, we think some kind of receipt or written information at least provided on the screen itself. When it's a transaction done over the computer should provide the amount of the sale, the fees charged, and the amount remaining on the stored value card.

For those transactions under \$5, just the basic information of how much am I spending and what are the fees that are attached. Those can be, if it's on a coke machine or a meter, all by fixed stationary signs.

And for a reasonable fee, which is obviously as determined between the consumer and the issuer, the consumer should be able to go to some device provided by the issuer to get a transaction history.

As I said, we don't expect industry to embrace this idea. But I hope you can see what we think is at least a minimum layer of protection. From everything I have heard today and previously, I don't see how this type protection would limit the development of brand new products in this marketplace. Thank you very much.

CHAIRMAN LUDWIG: Thank you very much, Ms. Saunders. Mr. Smith.

MR. SMITH: Thank you, Mr. Chairman. As we've seen from the discussion earlier this morning, there are a wide variety of electronic money products in and soon to be in the

marketplace.

Some of these products are in the roll-out stage. Some are in the pilot stage, and others are in development. The benefits and risks to consumers, merchants, and issuers will vary significantly across these different products.

As a general matter, this wide range of products will make it quite perilous to attempt to mandate one size fits all consumer protection rules. My testimony this morning will first address consumer disclosure issues.

I will then turn to broader consumer protection issues such as limits on consumer losses. As for consumer disclosures, Visa believes that it is entirely appropriate for there to be different disclosures either for the same product offered by different issuers or for different products.

The appropriate disclosures may depend on such factors as the underlying technology of the product or the use for which the product is intended.

We believe that the standards for what is full and fair consumer disclosure are best defined by experience in the marketplace rather than by government regulation.

This point can be illustrated by comparing the disclosures provided for the two Visa electronic money products I discussed earlier this morning, Visa cash and Visa TravelMoney. In the case of Visa cash, the information disclosed to the consumer is determined by our member that issues the card.

These disclosures typically are provided when the consumer purchases the card. These disclosures may be provided to the consumer in a variety of ways.

Certain issuers may determine in the context of their programs that it is most effective and efficient to place disclosures on the card itself. Other issuers may decide to post the disclosures at the sales location or provide the consumer a separate disclosure document.

The consumer disclosures for Visa TravelMoney are quite different. At the time a Visa TravelMoney card is purchased, the issuer provides to the consumer a detailed, written disclosure setting out the terms and conditions governing the card.

Although these terms and conditions will vary slightly between issuers, all U.S. Visa issuers will disclose the detailed information listed in Visa's written statement.

This information will include how the consumer can receive transaction detail for card transactions, the consumer's liability for unauthorized card transactions, and error resolution procedures.

Given the significant differences between the Visa cash and Visa TravelMoney products, we believe these differing disclosures are entirely appropriate. In effect, the market is telling us that different disclosures should be provided for these two different products.

Indeed, requiring a Visa TravelMoney type disclosure

for Visa cash could well result in Visa cash no longer being economically viable. Moreover, based on our experience to date, there is no compelling need for the government to mandate electronic money disclosures.

Consumers are not telling us that they are confused about these products. Consumers are not telling us that they should have received different disclosures from those that were provided.

Consumers are not telling us that they should have received their disclosures in a different way. As for consumer protection issues more generally, Visa feels very strongly that consumer protection regulations should not be imposed on electronic money at this time.

Given the early stage of development of these products and the many pilot initiatives that are being tested in the market, we are confident of two things.

First, no one knows what consumer expectations are for these products. Second, whatever consumer expectations turn out to be, products will be offered to satisfy those expectations.

For example, if reimbursement for a lost or stolen stored value card is expected by consumers, we believe products will be available to satisfy that expectation. Products that do not satisfy consumer expectations simply will not survive in the crucible of the marketplace.

As I stated earlier this morning, given that electronic money products are still in their early phase of development, premature consumer regulation of these products could well have severe unintended adverse consequences.

At the extreme, compliance with premature regulatory requirements may simply be technically infeasible for some of these products. For other products, compliance may be technically feasible, but the expense of compliance may result in the product no longer being economically justified.

This is a particular concern for those electronic money products intended for small dollar transactions. At a minimum, consumer regulation of electronic money products at this time likely would preclude their optimal development.

Development of these products should be dictated by such factors as technological capability, economic viability, and consumer demand. Not by government regulation.

As I discussed earlier, these products hold great potential to benefit consumers, merchants, and other payments participants. Premature regulatory action could well have the perverse effect of denying consumers and society the benefits of advanced payment systems developed in response to market forces.

In conclusion, Visa feels strongly that federal and state regulatory authorities should refrain from imposing consumer disclosure or other consumer protection requirements on electronic money at this time.

Issuers of these new products must have the flexibility

to develop and structure their products in a manner consistent with that response to the marketplace demand. This concludes my testimony.

I'd be pleased to answer any questions you may have regarding my testimony or the written statement that we provided. And of course, I'd be glad to respond to the proposed bill that's been put out there this morning. Thank you.

CHAIRMAN LUDWIG: Ms. Rinearson.

MS. RINEARSON: Hi. I'm Judie Rinearson. I'm Group Counsel for American Express. Until four years ago, I was Group Counsel for the Travelers Cheques group.

And in the last four years, life has been very exciting because the way American Express is viewed, the stored value industry is really a connection to the travelers check, which is a paper stored value product.

Most of you, I hope, have seen my summary statement. And I don't intend to spend my brief time here repeating what's in that statement already.

What I'd like to do is talk about how Amex is focused on consumer needs in developing some of these new products and to talk about our hopes and fears for the future and with respect to regulation. I am, however, of course happy to answer any questions anyone might have on the summary statement.

When American Express started looking at stored value products, they started out by asking basically, "Why on earth would anyone want to pay for something today when they could pay for it tomorrow?"

And we took a lot of time talking to consumers and talking to our card members. And we found there really were two really good reasons. One was control.

We do a lot of corporate cards. And we have a lot of corporate customers. Many of them came to us and told us that they weren't happy having only a credit product and wanted to be able to give their employees something other than a credit product, something that would be fixed amount to cover their expenses.

Essentially, we use the term per diem card. We're now testing this with the government with something we call the government funds card. And for employees, sometimes it's for temporary employees or contract employees who are going to be taking a trip with \$100 per diem.

If it's a three-day trip, they get \$300 on the card. It's a mag stripe card. And they use it basically anywhere an American Express card is used. However, it's not a credit instrument. They can't go over that amount.

We also have another reason that people like pre-paid products. It's a nice way to give money to somebody else. When corporations are paying incentives or awards to their employees, historically they give things like gift checks.

They have catalogues where they give them prizes or

globes or vases. Now, we have a product called the incentive funds card.

And an employer can give them a card that's loaded with a certain amount of funds. A lot of times the funds are gained during a sales program over a couple of months.

So, those are two good reasons why you would have a pre-paid product and not a credit product. For all of American Express products, the heart of the agreement is our contract with our customer.

A lot of people don't realize that a traveler's check is also a contract. It comes with a small purchase agreement form. And when you buy it, you have terms and conditions.

Of course, everyone knows credit cards have terms and conditions as well. So, when we started looking at these products, the first thing we did was think about what are the terms and conditions?

What is this contract that's going to be between us and our customer? I was noticing here I have a metro card from the New York subway. And they don't really have terms and conditions.

I think a lot of things about terms and conditions is it's a little bit cultural. I think when you move from a token to a card like this, you just have subject to applicable tariffs and conditions of use.

I've never found where anyone can get the applicable tariffs and conditions of use. American Express, of course, we're used to terms and conditions. We're pretty much run by that.

So, most of our cards do have, when you receive them, a set of terms and conditions often in a brochure. If it is a product that has a customer that we know and that we are going to be sending updates on their spending such as with the incentive funds card, then we will also have an enrollment form.

And sometimes there are terms and conditions on that as well. Now, I've provided for the panel here some sample terms and conditions at Lucy Morris' suggestion just to give you an idea of the kinds of terms and conditions we use now.

I say it with a little bit of hesitancy. You know, these things change as you develop. And I'm a person who ended up writing a lot of those. And every time I look at them, I think of something else that I might change later.

As we develop and learn, we are just going to find more things to add, more things to change. One of the things that we mentioned in my summary statement was that one of the most often asked questions of us is, "How much is left on my card?"

And so, one of the newest things we've come up with on our newest card which is a travel funds card, which is our version of an electronic traveler's check, is it comes with a little ledger to help you keep track.

Will it work? I don't know. But we're trying to be as

responsive as we can, something besides having an 800 number. So, as I said before, disclosures and contracts are the key to the relationship.

That's also true for the merchants as well. And that's where we would look to solve those issues.

Fears. The good news is, is that so far there hasn't seemed to be that much to fear from this. I know it's possible. I was on the ABA committee that looked at the commercial law aspects of electronic commerce.

And we spent a lot of time, that's what lawyers are good at, thinking of everything that could possibly happen. But in practice, and I think this is shared by my colleagues as well, there has been little to really show that there's a basis for these fears.

So far, so good. Will there ever be a problem in the future? Of course. We're going to have problems. But the good news is that these products seem to be handled well.

They seem to be working. Customers seem to be very happy with them. The fears that I've heard about the most, of course, are losing money. None of your consumers want to lose their money.

On the other hand, everyone is carrying cash these days. And there is something that is not refundable. The nice thing about most stored value products is the amount that you can lose is limited.

You're not losing an ATM card that's going to get access to your bank account. You're really talking about losing a discreet amount.

One of my biggest fears is an industry failure. And I really appreciate the fact that Professor Budnitz and Ms. Saunders talked about having some guidance on what to do about nonbank issuers, the smaller issuers.

We've been talking about this as well. There is a network of laws that regulate non-banks in the money transmitter business such as travelers check issuers. And there's also been suggestions that nonbanks would come under those licenses.

We had a recent meeting of the Money Transmitter Regulators Association in Williamsburg. And the state of Texas actually circulated a document talking about how they believe that electronic commerce would come under their state money transmitter laws.

So, we're going to see not only from the federal side, but the states looking at these areas as well. Another fear for me is uniformity of regulation at the cost of innovation.

I'm really nervous about putting a square peg into a round hole. As you can hear, our products are very different from the e-purses that you've heard about.

And I'm very concerned that we're going to be asked to somehow adjust our products to fit some idea of what the technology should be or some idea of what the law should be.

I think the most important thing for consumers is that they have information and that they have choice. And it would make me very nervous if we ended up with a world where because all cards have to be refundable or offline cards don't have to pay refunds that suddenly you're going to be forced into one technology or another.

To me, that's a major concern. And I think that's something that was also recognized by the Fed's report in March.

Last, but not least, we are worried about premature regulation. We agree 100 percent with Visa on this one and would like to see instead -- and I should say that this is becoming a major issue among industry.

There's been a lot of talk about self-regulation. And I don't know whether that will work or not. But you're hearing it more and more in places like the smart card forum about industry getting together and recognizing the fact that since there are not clear laws right now that it's up to industry to be responsible, to be leaders.

This proposed regulation, legislation, I think is excellent because it gives us some guidelines without necessarily having to have laws in place. We have to be the leaders.

We have to be responsive to our consumers' needs. And so, that is where I think for now industry is going to look. I think it's much too early to actually have regulation.

Because it was very clear not only from this panel, but from the earlier one that we're really in the infancy in this. And if you start regulating now, I really think it's going to impact the future of this whole area. Thank you.

CHAIRMAN LUDWIG: Thank you very much, Ms. Rinearson. Mr. Plotkin.

MR. PLOTKIN: Judie's comment about the New York transportation card brought to my mind a question I've always had about the fare card locally, which is that it gives you an opportunity to sign the card on the back.

And I'm not quite sure what the purpose of that is. Along with that remark, I'll also discard the other opening remark my wife told me not to make, which was to invoke the saying of Sy Syms that an informed consumer is our best customer.

The fact is, though, and I know that both Lamar and Judie agree with me on this, that an informed consumer is the only way these products are going to take off.

All three organizations on this panel today, MasterCard in its capacity as an investor in Mondex, Visa and American Express, already enjoy a tremendous amount of consumer confidence.

That's a result in part over time of having excellent consumer education programs, of having financial integrity and stability, and of delivering products that consumers want and can afford.

Each of these organizations has at one time in its

history or several times pioneered products such as credit cards, debit cards, or traveler's checks that were novelties at some point in the past and that were virtually unknown to consumers and that lacked substantial competition that helped to define them.

Notwithstanding those challenges, those products, while at one time not at all indispensable, have become indispensable to the traveling public and to the consuming public.

These products, stored value cards, present a very different kind of challenge, a much more difficult challenge I think for these organizations to introduce.

And that is because there's already a substantial competitor in the marketplace. And it's cash. Cash is something that everybody understands. They can get it at cost.

It's ubiquitous. It's available everywhere. And if they don't like what Visa or American Express or Mondex and MasterCard have to offer, they can certainly turn right back to cash at no cost to themselves.

Now, we've all made some reference to the fact that the marketplace and market forces will have a moderating influence on fees and practices in our industry.

And it's not unusual, I know I did this in college myself, to come back as a consumer advocate and to point out with disdain that the market is in fact often inefficient because consumers are not necessarily informed and are unable to make economically optimal choices.

But I think that stored value cards, unlike certain other types of products, including, for example, a pre-paid telephone card, present the perfect paradigm for self-regulation as opposed to regulation that emanates from the government.

That's because when somebody sells me a pre-paid telephone card that says it's worth 15 minutes of domestic telephone service, and it turns out that that's 15 minutes of domestic telephone service at 11:00 at night on a Saturday, but it's eight minutes at one point during the week and it's three minutes at another point in the week, I mean, this is something I don't understand.

I really don't understand. And that's why I don't use them. On the other hand, a dollar is a dollar. And everybody understands the value of cash.

Further, notwithstanding the fact that my colleague, Mr. Miller, who was on the previous panel, would like to see that stored value cards become indispensable, right now stored value cards are not indispensable to any consumer.

And in order to earn consumer acceptance, we're going to have to make them as attractive as cash, or in fact more attractive than cash. So, accordingly, we have a heavy burden.

We have to make a product that's at least as secure as cash, more convenient than cash, and that offers more value than money.

I'm going to have to go through now and strike out all the references I made to infancy in my remarks since Judie and Lamar have covered those bases. But I guess the thing I would really like to focus in on is that in light of this, we're not talking about credit cards.

And we're not talking about debit products. We're not talking about products that can potentially link to someone's checking account, with certain exceptions at least in the Mondex situation, that can give someone access to the pot of gold that is an asset account someplace else.

When you're talking about a stored value product, at least in the Mondex scenario, you're talking about something that really is much more like cash. And keeping that in mind, when we start talking about Regulation E and electronic funds transfer act type regulation, we're thinking in a box.

And it's a box that is the box of credit cards and debit cards and the ability to access electronically consumer asset accounts. That's not what we're talking about here.

The fact of the matter is that we don't expect that consumers will be walking around with anything more in their pockets than a Mondex card, for example, than the amount of cash that they would ordinarily carry around, at least we hope they won't.

Accordingly, the consumer risk to the extent that there is any risk at all is about the same as it is with cash. We intend to limit the value on a Mondex card to about the same amount of money that a consumer could withdraw at an ATM.

Again, the notion is that we want consumers to understand that this is cash or it's like cash in any event. And we're going to make sure that they know that they need to safeguard it where it can be used, where it cannot be used.

Without adequate and thorough consumer disclosure, detail, education, we're not going to be successful in the marketplace.

It's easy to say on one hand that we are being offered through the stored value card act, the protection act, a form of regulation that is relatively light, that shouldn't impose a lot of costs, that really is sensible and logical, and we shouldn't as an industry argue with.

However, as my colleagues in the industry have already indicated, any kind of regulation entails a certain kind of cost, the printing of disclosures, the printing of receipts, the harboring of reserves over ten years of time to reimburse value that may have been misplaced or lost in the bottom of a dresser somewhere.

All of these things are costs that ultimately may destroy the industry because it will not be able to compete on a cost-effective basis with cash to the extent that there is consumer confusion in the early stages when we have pilots, to the extent of Professor Budnitz or someone else can go to Atlanta

and pick up a card and not be exactly sure what it is.

As Judy said, we're working on disclosures. We're learning from our experiences in pilots. All of these other products are being tested now in trials.

And as we do that, we will come up with better and better disclosures that ultimately, as Ms. Saunders indicated, the marketplace will respond because we will create a disclosure that will cause consumers to want to have this product and not necessarily want to have cash, that they'll find this is indispensable. We're running late. So, I'm going to stop there.

CHAIRMAN LUDWIG: Well, thank you very much, Mr. Plotkin. These are all very useful and really interesting presentations.

Let's explore the legislative option that Professor Budnitz and Ms. Saunders presented today. And I'm interested to know why you've chosen a legislative vehicle?

There are two parts to my question. One, I'd be interested in the industry's response as to your rather telling comments, at least from your studies, on uniformity and lack of disclosures in the pilots you've looked at and how industry responds to that.

Maybe there shouldn't be any uniformity at this stage. And maybe that's your view, but maybe it isn't. And I'd be interested in comments on the disclosures.

However, assuming that there hasn't been uniformity and there have been instances when disclosures have not always been made, why you move towards a legislative vehicle as distinct from industry self-regulation or other approaches to dealing with the issue?

MR. BUDNITZ: I'll give my answer. Then, Ms. Saunders will give hers. We have not prepared answers in advance to make sure that we will be uniform or even consistent. We have our own independent views.

But Ms. Saunders, in her opening remarks, I think already provided part of the answer. To me, it was telling that my study was based on the top end, Visa, three major, major regional banks and so forth and what they were doing.

We have a great concern for the lower income consumer. Mr. Plotkin was talking about, well, he won't buy a pre-paid phone card because he can't understand the pricing.

But the lower income consumer we fear will buy lots of stored value products and not fully understand. And hopefully not too much will be loaded onto those cards before they realize that perhaps at least some of the cards are not a good value.

But for the lower income consumer, the loss of that value is a very severe hardship. We are worried, therefore, and we are focusing on the needs of the lower income consumer.

And we are focusing on, as Ms. Saunders said, what I call the fringe bankers who may get into this industry as well as we have seen in the pre-paid phone card industry.

And so, when you talk about self-regulation, then I wonder how you are going to be bringing in the fringe bankers and how you are going to be focusing on the needs of the lower income consumers which may not be the market that your particular companies are targeting, but are being targeted by others.

We do not turn to regulation lightly, that is, without serious consideration because we know it will engender immediate, I would say, knee jerk reaction and opposition.

What we are proposing here is the most minimal of regulation. Do you really object to there being terms and conditions that are disclosed to the consumer? Do you really object to requiring that there will be an expiration date on the card?

I would like to hear what your specific objections are to our bill in terms of these most basic kinds of things. You're saying the marketplace will take care of it.

Well, we have seen already in Atlanta the marketplace did not take care of it. The disclosures were very inadequate. So, that is partial response for why we turn to a model act.

One final point, I used to work for the Securities and Exchange Commission. And so, I was very familiar with self-regulation. You have the NASD.

And that's, of course, another kind of a market with very different kinds of consumers, much better educated people who can afford to lose money a lot more easily than the lower income consumer. And we had mixed results in terms of self-regulation in that industry.

In some respects, it works well. In some respects, it's been inadequate. And other things have had to be brought to bear to make sure investors are protected.

MS. SAUNDERS: We tried to put something down on paper to get us thinking about some things. And we've already gotten some attacks from our colleagues as not going far enough.

And I'm sure that there will be problems in the ten-year issue that you brought up, Mr. Plotkin, maybe a true one that we should address.

But the reason we went to legislation is because if we don't do legislation now, what we will have we think is in ten years such diverse products that have developed with a consumer expectation on those products that do not have uniform disclosures and uniform protections so that it will be impossible in ten years to overlay even a modicum of minimal regulation like we have now.

Because we'll say now, well, Visa and American Express have these disclosures and they clearly work. Why force them to make disclosures in this different way?

And the answer will be not because American Express' and Visa's disclosures don't work, but because we need some uniformity to apply to the other providers in the marketplace.

I've been out of college 25 years, more than 25 years,

Mr. Mark Plotkin, and I still don't say the marketplace works for low-income consumers. We see it with the prices charged to cashed checks by check cashers.

Statutes governing money transmitters are completely meaningless insofar as providing basic consumer protections to low-income consumers in the marketplace. Only 11 states have any limits on the rates that check cashers can charge.

Eleven out of 50, 51 counting D.C. So, we think that we need to develop, hopefully in concert with industry, a minimum level of regulation which will allow this industry to go forward and yet set the floor for regulation for when other providers step up to the plate and start providing these services to my clients.

CHAIRMAN LUDWIG: Very helpful. Maybe begin with Mr. Smith and move around the table with regard to the industry participants. So, what's wrong whether it's in legislation or regulation or how you deal with sort of uniformity in some set disclosures?

And is there today a lack of uniformity? Admittedly, it's just a number of pilot cases, but how do you respond?

MR. SMITH: Well, as I indicated in my remarks, there's a difference between a higher stored value product like Visa TravelMoney where we do have specific disclosures that each issuer must comply with and Visa cash which is a much lower value product.

And I would agree with the two people on my right more than you might have thought in a lot of respects. And one important respect is that I do agree with you that lower income consumers will be major users as well as major beneficiaries of these products.

Visa cash in particular is a bank-based electronic funds transfer tool that does not require you to have a bank account. And for those unbanked segments of our population, this will give those individuals access to bank payment systems.

And I think they will benefit tremendously. Now, I don't in any way question the need to debate the wisdom of various types of disclosures.

And I think it's very healthy, as Judie said, that we need to get this on the table. But we also have to keep in perspective what we're about here. We have credit card payment systems, debit card payment systems that have very extensive disclosure requirements and all sorts of regulations.

Those payment systems are not usable in the payment environments that are targeted by a product like Visa cash. Why? Because they're too expensive.

You cannot justify the cost of a credit card payment for a \$4 or a \$3 purchase in most instances. So, what we're trying to design is a product that can bring the advantages of electronic technologies, electronic transmission and data processing technologies, to your lower value payment

environments.

And we go about cutting those costs in a variety of ways. The Visa cash card in particular cuts those costs, for instance, by not having a online authorization clearing and settlement connection between the point of sale and the acquiring bank.

You eliminate the cost of the electronics there. You cut the cost of the transaction. You make the product cheaper to use.

Similarly, in the clearing and settlement process, the clearing and settlement message on a Visa cash transaction is truncated at Visa. That information is not sent back to the issuing bank.

A major cost savings. Now, we've got to look at consumer disclosures in the same context. It's a trade off. Consumer disclosures in the abstract are clearly an advantage, a social good.

But are they a social good if you carry them to the point where they kill the product, a product that we believe will benefit all sectors of society, including the lower income.

And it's a trade off that we have to look at, and we have to experiment with. And just as we don't know what technologies will be the best at the end of the day, so too we do not know now what consumer disclosures are affordable and truly of essential importance to the consumer.

And all we're saying here, I believe we're saying in conjunction that we need to experiment with this. And we're experimenting in a low-dollar payment environment. In the Visa cash card, the maximum you can put on the card is \$100.

CHAIRMAN LUDWIG: Thank you very much. Ms. Rinearson.

MS. RINEARSON: I basically agree that the cost is a big factor for regulation at this time. Also, as I mentioned in my earlier remarks, regulation that would automatically result in different levels of regulation for different kinds of products that would also, in my mind, be a very difficult impediment to this industry for it to survive.

One of the questions that Mr. Budnitz asked is give me an example of why someone wouldn't want to put, for example, an expiration date on a card? Actually, I have an example.

For our pre-paid telephone cards that we issue, we have started something called point of sale activation. It saves a lot of money. It means that you're not shipping in transit across lines.

You're not shipping active cards that have value on them. They're inactive. They're inactive in the store, in the inventory room. And that saves money for the store merchant who doesn't want to have something that's very costly sitting in their back room.

It cuts costs and saves a lot of money. Well, the thing is is that you hold onto those, and when you sell them, you

swipe them through to activate them. And then, they're active for a year from that time, or two years from that time.

So, those kinds of things you can't have a printed expiration date on the card. The most you can have is something like expires within two years of first use or something like that.

But again, I've seen some proposed regulations on the pre-paid phone cards where they've actually suggested that there be a date imprinted on the card. And that's just not feasible.

I think the most difficult part about regulation at this time is that we just can't even foresee what's going to be happening in the future on the technology side.

And I guess I still lean towards at this point, just at this juncture, I'm not saying forever, but at this point trying to work out some sort of guidelines together, mutually, industry and consumer groups so that we can have products that will meet the consumer's needs, but without imposing at this stage legislation.

CHAIRMAN LUDWIG: Mr. Plotkin.

MR. PLOTKIN: I agree with everybody at the table that consumer disclosures are important and are warranted. And that is something that each of these organizations is focusing on.

How can they educate consumers and create effective disclosures in an economically viable way? I know we, at Mondex, are in the process right now of developing disclosures for the joint pilot we're doing in the upper west side of Manhattan with Visa later this year to make sure that consumers understand what the product is.

At the same time, and Lamar referred to this, we have to keep in mind that we're really on sort of a sliding scale from credit and debit card products down to cash in terms of what we're trying to offer consumers.

The Mondex product, for example, technologically the way it was developed was developed to be very low cost, to not require telephone communication to accomplish a transaction, for example, which increase costs, to provide the same kind of information, to provide the same kind of protections that are associated with a credit or debit card.

And I realize that that's not what's proposed. We're proposing a considerably different regime than a credit or debit card. All those things will add costs that may make it not viable to introduce into a low-income or moderate-income neighborhood.

The fact is that our target market in many ways really are low-income consumers, people who use cash. Our target market is not people who conduct most of their transactions using credit cards.

Because the credit card environment basically occupies \$10 and above transactions. Our target market is people who want to use this product to pay at a parking meter, to pay in a

parking garage, to buy a newspaper, to buy a cup of coffee.

At the same time as we're debating how much protection we should layer onto these products for consumer education, for consumer protection purposes, we should also be thinking about what the benefits are that accrue to low-income consumers who will use these cards.

Those benefits include decreased reliance on the inner city check cashers and money order sellers. It will include potentially bringing in, as Lamar said earlier, unbanked consumers into a quasi-banking environment.

You needn't have a branch of a bank in the inner city or in a rural area in order to use the stored value card, especially if you have access to a telephone line.

This has a potential to actually bring people into the banking system who don't have access to a branch right now. It has the potential to bring merchants back into the inner city where they don't have to worry about having cash on the premises.

If you can use a stored value card, then perhaps you can -- in fact, I'm thinking of the example of Scan furniture here in Washington, which actually stopped accepting cash on its premises a year or two ago because they were concerned about getting robbed as frequently as they were.

This has the potential to benefit low-income consumers if we can keep it inexpensive. Without that, we're going to throw the baby out with the bath water.

CHAIRMAN LUDWIG: Okay. Let me ask now if any of our panelists have questions. There are several others I'd like to ask.

MR. HOVE: I guess I hear from all sides of this panel that there is a real need for consumer disclosures, but where it is is really the question. And Professor Budnitz and Ms. Saunders have suggested a statute.

And I think I heard from everyone else that you're very concerned about disclosures and the ability for people to use that. And I'm wondering where do these things come together?

Do they come together in regulation or guidelines? And how can we bring these two really opposite ends to some meeting point? And that's kind of what I'd like to hear. Is there a common ground?

Professor Budnitz, do you feel that the only way to do this is a statute or if there are some guidelines that would be issued that puts some uniformity in this?

MR. BUDNITZ: My immediate reaction is who is subject to the guidelines. The OCC issued some excellent guidelines. They're only guidelines, not regulations.

And they only apply to national banks. And then the Fed has its own banks that are subject to Fed rules. And, of course, the Fed has to decide what to do in the Thrifts.

And there's others who are not subject. I guess they're under the FTC. Would there be joint industry guidelines?

And then, what are the effects of guidelines on the fringe bankers, on the rent to own, cash checking, whatever else store that's going to be issuing this?

What we have at stake is the integrity of a payment system. In fact, a payment system which in the form of a card may double, triple as a debit card, a credit card, and a stored value card.

It all rests on trust, on the consumer's trust. Or else it all comes crumbling down. And so, just guidelines which really have no legal authority at all that can be ignored at no risk at all.

I'm not sure what we gain by that. And they would require all these different agencies to agree in order for there to be uniformity which may not be capable of accomplishment. And so, I just have some reservations about guidelines.

MS. SAUNDERS: I'll state what is probably perfectly obvious that we are all taking our natural position. The consumer advocates are saying there must be legislative protections.

And the industry is saying, of course, no, no. I wasn't there, but I believe I have heard that when the electronic funds transfer act was first passed that there was a similar vehement opposition by industry.

There are some significant differences between cash and stored value cards, especially for low-income consumers. One is I would proffer as another reason for legislation, legislative protection.

If you wash your money, wash your five dollar bill in your jeans, whatever crumpled form it comes out in, you can still go to the bank and get it back. If you want to send your ten-year old son to the corner to get a loaf of bread, you can send him with two bucks.

You don't have to send him with that week's worth of money. And you know everybody will accept cash, except for Scan furniture, but all the grocery stores.

United States currency is universally accepted to do business in this society. Stored value cards don't have those same features.

Let me use again the telephone card example that Mr. Plotkin raised. I'll bet one out of all the people in this room, two, have relied on stored value telephone cards to make long-distance telephone calls.

Don't we all have our nice little AT&T or MCI long-distance credit card? We probably do. It's only my clients, low-income people, that are relying on stored value cards that they get at K-Mart to make long-distance calls.

And those are the cards that we're having all kinds of trouble with. That's why we think there must be a uniform legislative response.

And we're very willing to sit down with industry and

try to work out what that response should be. The reason we put this on paper was to prove that it could be done, not to say that this is the end all of the regulatory response.

MR. SMITH: Just as a quick aside, my first response I talked about the agreement that I have with the two people sitting on my right that the lower income individuals will be among the greatest beneficiaries of some of these new technologies and these new products coming on the market.

I failed to mention another area of substantial agreement. And that is in my statement I am talking about micro, what I would call a micro-issue on consumer disclosures by an individual issuer of these products.

And I think industry can handle these issues at the present time best through experimentation and trials. Industry cannot in itself necessarily handle another issue that these two individuals raised.

And that is, the financial integrity of people who are coming into this marketplace and issuing these products.

And I think that there is a role for government in making sure that, as this new technology, this new payment tool becomes more generally used, that you don't have a situation where an unqualified, a financially risky issuer of stored value products has such a volume of that product in the marketplace and then goes under and causes the holders of that product from that particular issuer to lose all of their value.

Because that could have a substantial impact on consumer confidence in what may become a major component of our nation's money supply, a major payment tool.

And we've all known of examples in history of what happens when the general public loses confidence in a particular payment instrument. And I do think that that's something the government should pay a lot of attention to.

I'm not sure that legislation is necessary, but I think we need to make a clear distinction between consumer disclosures and the bigger macro-issue of consumer confidence in what promises to be a major payment tool, a major component of the money supply.

MS. RINEARSON: I'm going to have to agree with Mr. Smith once again. I almost feel like you've been looking over my shoulder here. I wrote down guidelines for disclosures, but safety and soundness. I agree.

This goes to the heart of the industry. This is something that with the state money transmitter regulators always spend a lot of time talking with them earlier this month.

There are laws out there that regulate entities that take money from the public. And they do things such as requiring, as Glenn Weiner mentioned this morning, 100 percent of the outstandings are held in permissible investments which is something that American Express does for its cash-like stored value products.

There are licensing and bonding requirements. There's already a network of these laws out there. And we think that it is fully appropriate that these kinds of laws do get applied to stored value issuers.

I do want to point out one issue, one of the things that Bill Norwood who was from CyberMark mentioned.

There is a difference between, I guess a cash-like product as opposed to pre-payment for goods and services. I guess I'd be a little nervous if any store that wanted to issue a gift certificate that suddenly they're going to have to get licensed.

If you're only dealing with a pre-payment for goods and services, then to me that's a different matter than having a cash-like product where you receive cash and you pay back cash. So, that's at least where I would draw the line for the licensing.

MR. PLOTKIN: Just to get my two cents in as well. I too am afraid I have to agree, which I hate doing. But I agree that where the risk is, and I've taken exception to the proposed legislative solution.

And I've taken exception to it because we know that we will not be abusive in the marketplace. And we know that our colleagues at the table will not be abusive in the marketplace.

But the fact remains that there are others out there who could come into the marketplace and who could abuse consumer confidence. And it would hurt all of us.

Part of our objective, the objective of Mondex and I'm sure of Visa and American Express as well, is to set a high standard in the marketplace in terms of consumer disclosure so that we generate the kind of consumer confidence that makes people want to buy these cards and make it a good deal all around.

But there is, unquestionably I think, a place for government at all levels, state/federal, to make sure that those on the margin who come in and try to ride on the successful efforts of the Mondexes and Visas and American Express out there don't take advantage and steal away in the middle of the night with people's value.

MS. BERNSTEIN: Yes. I guess in the interest of very full disclosure, my daughter lives on the upper west side of New York. And for that reason, I'm particularly interested in that pilot program.

And more seriously, I wanted to ask two questions about it. The first is, and you've all mentioned the need to experiment. I know it's under development, so I'm not going to ask what disclosures are underway because I know there will be some.

Are you also contemplating perhaps segmenting the possible customer base so that different disclosures could be used for different populations in order to test them and see

which are the most effective or the most burdensome?

And secondly, what kind of follow up do you contemplate for after the fact, both in terms of the overall satisfaction, but more particularly on the usefulness of disclosures and which formats and where they were used?

That would be helpful to all of this group in evaluating what future needs are.

MR. PLOTKIN: First, I am not sure without going back and checking with my colleagues at Mondex whether we are planning different kinds of disclosures for different population segments in the upper west side pilot.

However, now that you mention it, that actually seems like a very sensible notion. And it may be that others, more thoughtful than I, at Mondex are now preparing that.

But it's something that we ought to talk about because it would be helpful for the second part of our pilot which is to follow up with surveys of merchants, customers, and the participating financial institutions to find out what their experiences were, where they had confusion, what we might do differently.

And hopefully, we'll get a mark up from people of our written disclosures so we can get a sense of what we could do better. But the notion that we might try out different disclosures on different market segments sounds like a very valuable idea.

MR. SMITH: Well, an opportunity to disagree slightly on an issue. I'm not completely familiar with all the details of the New York pilot. And some of them have not been worked out.

But let me give you an example from the Atlanta pilot with Visa cash. A major way of dispensing the Visa cash stored value card in Atlanta was through free-standing kiosks where anyone can walk up like a metro fare machine and put your cash in and get a Visa cash card back.

You really can't distinguish among segments of the population that might walk up to any given kiosk. And I just don't know how you would do that.

There are advantages again to doing it through distributing the cards in this fashion. It's a very inexpensive way to do it. One of the issues that you raised, Professor, was privacy in these card transactions.

If you want absolute privacy as to your expenditures, all you have to do is buy your stored value card through a kiosk. Now, under the Visa system, we can account for every single transaction on that card.

We can go back and reconstruct all the transaction detail. But if someone purchased that card at an unattended kiosk, we have no idea who that individual was. So, you can achieve absolute anonymity that way. And that is an advantage.

MS. BERNSTEIN: But that wouldn't necessarily keep you, would it, Mr. Smith, from making different disclosures at

different kiosks? The transaction would be the same.

MR. SMITH: I guess conceivably in the upper west side there may be some kiosks that would be frequented by one group. Another kiosk by another group.

But I'm just saying there could be a potential problem. It's not a process like a credit card or a debit card where you necessarily know who the individual is and can design your disclosure in light of that.

MS. BERNSTEIN: It was merely a question on my part since we're all sort of struggling I think together in terms of understanding that consumers do need the information and what the best ways may be to obtain it.

MR. OLIVER: To what extent do you see, in talking about self-regulation, the terms, conditions, and disclosure thereof as a marketing tool that could produce product differentiation between competing products?

MS. RINEARSON: I think there's definitely an opportunity for that. And again, I guess American Express likes to pride itself on the fact that we always have full terms and conditions, plus 800 24-hour customer service numbers.

But if you go seriously down the self-regulation route, I guess the way I would foresee it would be, and this is just something I've been thinking about, would be some sort of seal of approval or symbol or something on a card or on the terms and conditions that the card holder would know that whoever is carrying this card has guarantees that it's refundable or guarantees that it's licensed, or guarantees that it provides 24-hour customer service.

So, from a marketing point of view, you could actually market, "Look for this label. It means quality." That's just an idea.

MR. SMITH: Just stepping in, and I promise that I did not ask Mr. Oliver to ask that question. I would say that's the beauty of a system like the Visa cash system where we have designed a fundamental product.

And we have the back end processing technologies to make the product work. But each individual issuer of the Visa cash product can set the disclosures made to its customers.

And believe me, this is a very competitive marketplace. If one particular issuer is not giving disclosures that consumers feel adequate or even a sub-group of consumers feel adequate, there is another issue of who is going to identify that as a market niche and exploit it.

And I think if I understand what you were driving at, can the marketplace itself determine the appropriate trade off between cost and disclosure, I believe at this point in time every indication is, yes, the market can address that problem. And I think it should be given the opportunity to address that problem.

MS. SAUNDERS: Well, I completely agree. I think the

marketplace will drive the development of this product. And that's our point, that it will only develop if American Express and Visa make a product that the people sitting at this table find useful.

And that's exactly our fear, that they will develop it on its own, on their own, and probably in very diverse ways. And then when my low-income client wants to go and buy the product, now they may go across the line or they may find the Visa product or American Express product in their community, but they may also not.

The United States Congress in 1980 deregulated interest rates on first mortgages. I'll bet everybody in this room understands the impact of interest rates on their mortgage and shopped very hard for a first mortgage to get the lowest monthly payment and the best mortgage for them.

That is not happening in the low-income community. The marketplace is not working there. We have seen clients all over the country in state after state that have abusive loan terms and are losing their homes at a higher, faster rate than has been seen in this country in decades as a result of the deregulation of the marketplace and the reliance on the marketplace of addressing these problems.

It works, I agree, to some extent among middle-income consumers. But our point is, and I know I sound like a broken record, but our point is it doesn't work in the low-income marketplace.

MR. PLOTKIN: I'll also just add in that from our perspective, the difference between abusive loan terms or the potential abuses in the securities industry are quite different and require considerably different consumer education than the difference between a \$20 bill and a \$20 Mondex card.

Our sense is that it should be reasonably clear to consumers whether they are better using a \$20 bill or a \$20 Mondex card.

We think that, and this is where my competitive instincts will come out as have my colleague's here, both within Mondex which is going to be comprised of many different member institutions each of which will be issuing their own Mondex card, there will be competition to distinguish themselves in the marketplace.

There will be competition between Mondex and Visa and American Express to distinguish themselves in the marketplace. I do think that there will be considerable fallout and shakeout in the industry, that there will be an evolution toward the kind of consumer disclosures that make sense.

But I also think that when we're talking about a product again on this end, and Lamar expressed it better than I did or than I can really, we're talking about something that we're trying to keep inexpensive, as close to cash as possible.

And for that reason, I believe that as long as we keep

things simple, it will be easier and more able for consumers to make the kind of distinction and choice between these products than they can between something that is much more complicated like a 30-year mortgage or a security for that matter.

MR. BUDNITZ: I was wondering if I could address one issue that came up in terms of the safety and soundness of the issuers. And there was frequent references made to the money transmitter laws that some states have adopted.

I have not done a 50-state survey, but from the few states that I have looked at, there's a wide variation in terms of the requirements placed upon money transmitters that some states are much more restrictive than others, more protective than others depending upon your point of view.

And so, what I would stress is that what you cannot do is say, "Well, the states have money transmitter laws. As long as those laws clearly cover stored value cards, then that problem is solved."

Because it's not solved at all. Wide variation, some states very weak. Just in quick reference to something Mr. Plotkin I think just said in terms of consumers knowing the difference between cash and Visa cash.

The very names of these products, calling them cash when they're really not cash at all is of great concern to me. Whether it's called Visa cash or Cyber cash or e-cash, it's not cash in the sense of currency.

And I think if we did a poll even among rather well-educated consumers, we would find that they are not aware of the federal statute that embodies the legal tender rule. In fact, they've never heard of it unless they've taken economics in college.

And so, there are very vast differences. We, the experts, don't even know all the consequences of those differences. And to say that consumers know the difference among all these systems, I think, is inaccurate.

CHAIRMAN LUDWIG: We're running a little over our time break for lunch. But if any other member of the task force has a question, I'm sure our panelists wouldn't mind staying a bit. Are there any other questions?

MR. MARQUARDT: If you don't mind, this could take us far field. And I don't mean to do that, but just to signal the issue. As I understand your draft bill, it would cover primarily stored value cards.

The question really much broader than that is, what implications would the concepts behind your bill have for the use of stored value cards over the Internet or Internet stored value payment mechanisms more generally?

I assume you're concerned about some of the same issues in that setting as in the card setting. And I just would be interested in your views, Professor Budnitz or Margot.

MR. BUDNITZ: You're quite right. Some of the same

concerns are present. I was going to say, yes. But that's more middle-class, upper income because you're talking about computers and Internet.

But that's not true either because, for example, President Clinton is making a big push to have computers put in schools all over the country. And I know that in my area you have public libraries that are putting in computers with more and more capability.

And so, it is an issue that involves the lower income consumer as well. We have to explore those issues. There have been at least reports of payment system problems using the Internet.

And it brings in, as was mentioned earlier, whole issues of digital signatures and electronic records, a whole other area. And so, yes, the short answer is there are implications as well for Internet, banking, and paying for goods and services. And these need to be explored as well.

CHAIRMAN LUDWIG: Well, I want to thank our panelists today. These really have been excellent presentations and helpful answers to questions. I'm sure we'll be speaking in the future.

A-F-T-E-R-N-O-O-N S-E-S-S-I-O-N

CHAIRMAN LUDWIG: Welcome to the afternoon session of our first day of public hearings on electronic money, the consumer aspects of same in particular.

This afternoon's first panel will be on issuer financial condition and reliability. We had two excellent panel discussions this morning. This, I think, will be really quite interesting and topical.

Because there has been a number of reliability issues relating to phone card issuance in New York which has been topical. And, of course, there have been historically issues with regard to money order firms that have failed and consumer well-being in that connection.

Let me introduce our panelists. We're honored to have with us this afternoon a number of distinguished panelists.

Ezra Levine, from the law firm of Howrey & Simon, is here for the Association of Money Transmitters. John M. Lewis, President of the Bank of Fayetteville, is here on behalf of the American Bankers Association.

Bill Norwood, Vice President for new business development of CyberMark is back with us this afternoon. Mark Plotkin of the law firm of Covington & Burling representing Mondex USA is here again this afternoon.

And Janice Shields, who's the Director of the Institute for Business Research is with us.

I propose we proceed as we did this morning going around the panel this way.

And if you could try to keep your remarks to about five minutes, that will leave plenty of time for questions. Mr. Levine, perhaps you might begin.

MR. LEVINE: Thank you, Comptroller Ludwig. My name is Ezra Levine. And I'm here today from the Washington law firm of Howrey & Simon. I have a terrible cold, representing the nonbank funds transmitters group.

Now, the nonbank funds transmitters group is composed of the leading nonbanks in the United States which currently issue traditional, low-tech, payment instruments like money orders, traveler's checks, as well as consummating electronic funds transactions like Western Union and Moneygram.

Some or all of these companies are now getting involved in the more high-tech products, smart cards, Internet transactions. All of these companies are vitally interested in the shape of regulation, whether that's at the federal or the state level.

And all of these companies are licensed under the state safety and soundness laws. Now, one of the reasons I wanted to talk today, and I'm very pleased that the consumer electronics payments task force asked me to come and speak today, is because this group, and I in particular, have been involved for the last

eight years in the continuing evolution of the state safety and soundness laws.

It's very important to remember that from the safety and soundness standpoint, the federal government which has had, to one degree or another I think it's fairly safe to say, a pervasive regulatory influence in the oversight of depository institutions, has almost nothing to do with regard to the safety and soundness regulation of nonbanks.

Now, historically, about 45 states have over the years promulgated state sale of checks laws which were the first iteration, which evolved into sale of checks money transmission laws.

And about six or seven years ago, the states got together, and these are of course the state banking departments, and formed the Money Transmitter Regulators Association to look at issues involving uniformity of regulation and how does one enhance regulation in order to ensure that consumers are protected.

There is, in fact, the model act. The model act has been adopted in many states. The goal of both industry and the state regulators increasingly is to achieve to the maximum extent practicable a degree of uniformity.

I was reading earlier, in advance, some of the comments that were filed, the American Bankers, Mr. Lewis' statement and others where people say generally, "Gee whiz, in the modern world that's occurring with the advent of new technology, it's important to protect safety and soundness just like banks are protected."

We don't disagree as nonbanks. We think nonbanks should be regulated. The infrastructure exists. And one important point that we always tell people, because most people particularly at the federal level, don't understand state safety and soundness regulation.

But for any multi-state licensee, any company that's going to do it on a large-scale in more than one state, you're in effect always bound by the law of the strictest state.

And the major populace states like Florida, California, New York, Texas have very, very similar, fairly strict regulatory schemes involving on-site examination at least once a year by state banking regulators, often of whom are folks who had worked one time or another either for the Fed or the OCC in an earlier lifetime.

But what they're looking at are the exact same safety and soundness concepts including net worth, liquidity. Bonds have to be posted.

And most importantly in about 20 states now, permissible investments, which is a very key concept meaning having a menu of permitted, that is to say permissible investments on the books of the corporation equal to on a dollar for dollar basis the outstanding instruments or transmissions.

So, it's in effect 100 percent reserve. So, that's an important factor. And I think my five minutes may have elapsed.

CHAIRMAN LUDWIG: No. That's all right.

MR. LEVINE: Is that all right? Okay. But we believe that moving forward, one can argue, and the Comptroller has chided me in the past when I've presented similar sentiments to the OCC, that isn't this really a balkanization?

And do we want a balkanization, meaning having the states do it rather than the federal government? I think certainly with regard to smart cards, smart cards are akin it seems in my view in many, many respects to paper instruments.

They're not the same. They're not identical. But they're in more ways similar than they're different, I suspect. There's no reason to think that the state laws can't work.

In fact, Texas recently has issued a ruling indicating that a smart card or a stored value card issued in an open environment by a nonbank is absolutely subject to regulation under the Texas sale of checks law.

Internet transfers, I think, are a far more complex issue because I think the balkanization argument frankly may have far more merit with regard to Internet transactions.

Because in fact, one wonders in fact since most of those transactions are certainly national, if not international in scope, how you regulate them at the state level is very difficult.

Although, obviously there are certain Attorneys General who are certainly looking at the nexus for regulation of Internet transactions in the area of pornography and perhaps more importantly for states regulation of gambling.

I guess it's Minnesota I think is taking the first steps in that regard. And Missouri is also. So, I suppose you can argue that the legal nexus may very well exist even for the states to look at that.

The states, by the way, through the Money Transmitter Regulators Association are about to form an informal task force to begin looking at what they ought to be doing in terms of recommending amendment to the existing model in order to encompass perhaps Internet transactions.

What I always tell the states when I'm representing my clients is, and I say this always to new upstart companies, "Look, it seems to me you don't want to be unlicensed."

And the reason you don't want to be unlicensed is because, particularly in new technologies, there's bound to be a failure in an open system if you're a non-bank.

And once there are failures of any size, major failures, and it's going to happen, politicians are going to jump on the bandwagon. Of course, what I tell the state regulators is they're going to look at those state banking officials and say, "Where were you? What did you do? You knew about this. You did nothing."

And then we're going to have bad law. That actually happened in the money order arena in California many, many years ago, probably mid-1980s when there was a failure.

And again, Comptroller Ludwig mentioned earlier failures in the money order arena. There really have been very, very few since I've been doing this which is about eight years.

I'm sort of a recycled antitrust lawyer. Something you can relate to. The I guess recent experience had been universal money orders, Circle K, a few. But almost no one in recent times has really lost money, because in fact the states have done a good job.

There's a significant amount of oversight. And I think the model there is good even if it became a federal model for nonbanks.

I believe that safety and soundness regulation makes sense. I think collectively, whether it's the states or the feds, someone needs to do that.

And I think an emerging industry needs it too. Made all these claims about, "Oh, my God, you're going to really hinder the industry, and the industry won't grow." That could be true, I suspect, if it's Internet transactions.

One needs to be very, very careful. But I think for smart cards, stored value cards in an open system that's different. I think it really is different because I think that's very, very similar to existing instruments, what I call low-tech technology.

CHAIRMAN LUDWIG: Thank you very much. I appreciate that presentation. Mr. Lewis.

MR. LEWIS: Thank you, Mr. Chairman. Ladies and gentlemen, I appreciate this opportunity to present our views before you this afternoon.

I am John Lewis. I'm Chairman of the Bank of Fayetteville in Fayetteville, Arkansas. And this afternoon, I'd like to focus on the public policy questions raised by the transition to a payment system that's based on electronic blips rather than paper currency and checks.

This transition represents a major change in our monetary system, and the way that it is handled by both the public and private sectors is critical to the future strength of the economy.

It is a matter of national concern, competitiveness of our economy in a global marketplace. My goal today would be to stimulate a discussion of how we get from here to there.

How do we facilitate this transition? How do we fit the new electronic world into the existing framework of laws and regulations that defines the paper-based system?

At this point, there are more questions than answers, very similar to my five-year old granddaughter. She has more questions than I have answers. But she's going to have to have answers soon.

But at meetings like this the basic questions can be thoroughly and openly discussed. And I hope some answers will soon take shape. Last year, I participated in the American Banker Task Force that looked at retail payment systems issues.

The task force reported highlights from four themes, maintaining the integrity of payment system, protecting the interest of consumers, promoting a competitive environment, and achieving a balance between the free market and regulatory interests.

The integrity issue got top billing from our task force because a safe and reliable payment system is absolutely critical to a modern economy. Electronic payment instruments like stored value cards are money by any of the usual definitions.

As their use grows, the failure of an issuer will have the potential to derail the financial settlement, or the final settlement, of thousands of transactions and leave consumers with devalued or worthless payment instruments.

It may not cause an overall system failure, but it would clearly shake public confidence in the payment system and could interrupt consumer spending.

So, a key policy question is who should be allowed to issue electronic cash and under what conditions and basically should they be regulated? Clearly, any issuer must meet high standards of financial soundness and responsibility.

Banks, by the nature of their charters and their extensive system of regulation and supervision, meet this task. But what about other financial institutions like broker dealers, investment companies, and insurance companies?

What about commercial firms? How could we assure that they meet the same high standards? Would we need a whole new regulatory structure? Does it make sense to apply a bank type model to this regulation?

Let's think about that for a minute. The bank model relies on a complicated system of supervision and regulation. And this model does not translate well the non-banks.

How could we assure that regulations would be applied equally across banks and nonbanks? What about differences in assets between banks and nonbanks? How would capital standards be applied and what would the organizational structure be?

What about applying an SEC type model based on disclosure? After all, electronic payment instruments have characteristics very similar to securities.

But how many consumers are going to read a prospectus every time they buy a \$50 smart card? How many would understand even if they did? Complications like these led our task force to conclude that with limited exceptions third party instruments should be issued only by banks.

And let me add two more observations. First, this is basically the way that it works today. Banks issue third party payment instruments. And second, the European central banks

looked at this same question and came to the same conclusion we did.

Before closing, let me mention a few other key considerations. First, the traditional consumer concerns, liability, unauthorized access, exposure to fraud, fees, privacy, and finality of payment will not go away in an electronic world.

These concerns must be addressed to promote acceptance of new products and maintain successful banking relationships. Second, we must find appropriate balance between market forces and government regulation.

We will all best be served by keeping the regulatory environment as simple as possible consistent with the need to safeguard the integrity of the payment system and the interest of consumers.

And third, we must recognize that payment systems are international. The United States does not and cannot operate in isolation.

We must participate in ensuring safe, secure, and efficient payment services in a global arena. Just in case I have not raised enough questions here today, let me conclude by summarizing what I believe are the key public policy issues.

How can we protect the integrity of the payment system? Who should be allowed to participate and under what type of regulatory oversight realizing that no one benefits if the system breaks down?

How do we assure that consumer's rights and privacy are protected? And what level of government involvement is necessary or desirable? Throughout history, the issuance and protection of currency has been the providence of governments.

I hope together that we can find an answer. Thank you.

CHAIRMAN LUDWIG: Thank you very much, Mr. Lewis. Mr. Norwood.

MR. NORWOOD: Thank you again for having me in today. And after listening to the two brief legal definitions here, I realize I'm totally in the dark.

But long story short, from a higher education and university standpoint, we follow a set of rules and regulations deployed on us by typically the state of Florida as has been in the past with us and the university as well as the division of banking and financing for the state of Florida.

The programs that were deployed up to date at Florida State University have been, up until 12 months ago, reviewed by the division of banking and finance for the State of Florida and approved as such for stored value or pre-paid value systems.

That had several conditions to go with it. One was that the university was a funds pool holder, which obviously obligated them to any failures within the system as far as who might owe consumers that had purchased cards or whatever else we use within the campus environment.

As we expand that basis, it's obvious that we are going

to have to explore the rules and regulations further to understand what's going on here. And it is obvious also that there is a real difference between a banking type based operation and those of us that are not "yet a true bank."

I sat here today not in total ignorance, but in partial ignorance because, one, CyberMark is an LLC owned by Sallie Mae Corporation, Batel Institute, and Huntington Bank Shares.

As of to date, we have not had time to sit down and discuss with Huntington Bank Shares what the relationship is between their ownership and our company and what that means to regulatory issues.

As we all know, business is moving forward rapidly. I come from the application side of the industry and the deployment of the systems, not from the regulatory side. So, to date, I could not answer the questions on what Huntington's involvement with us truly means.

But I am sure a regulator will tell us pretty soon what it does mean. Anyway, in summing up, we're anxious to understand what all this means.

We're also anxious and hoping that these regulations do not interfere with letting a lot of people work with the technology and try to make things happen that will benefit the consumers in the long term. Thank you.

CHAIRMAN LUDWIG: Thank you very much. Mr. Plotkin.

MR. PLOTKIN: I'm going to speak to the situation of Mondex USA in terms of issuer soundness because that's the paradigm with which I am most familiar.

Mondex USA is an interesting hybrid. It is organized as two affiliated limited liability companies, neither of which is an insured depository institution.

Mondex USA Originator LLC has as its sole business the issuance and redemption of Mondex value and the investment and secure liquid assets of 100 percent of the funds taken in from consumers and institutions that purchase Mondex value.

It's companion organization, Mondex USA services LLC, is the administrative and licensing arm of the Mondex USA organization. Notwithstanding the foregoing, although Mondex is not an insured depository institution, it nonetheless is supervised today by the Office of the Comptroller of the Currency.

This is a result of the fact that Mondex USA is majority owned by operating subsidiaries of several national banks which are themselves supervised by the OCC. In fact, the OCC has already been very much in evidence in the evolution of Mondex USA.

Just this past week, we had our first inquiries from national bank examiners who are coming into Mondex USA to learn about its management, its procedures, its policies, its business plan, and who have made it very clear that they will be with us, if not day-by-day, certainly month-by-month keeping abreast of

the operations of Mondex USA.

The fact that Mondex USA is not a depository institution has not kept it from being bound to some of the kinds of activities that one would expect a depository institution to engage in.

Our agreement with the OCC requires that we invest the funds that we take in from consumers solely in U.S. government securities and, at least for the present, short-term securities so that we can meet liquidity requirements.

In addition, Mondex USA Originator and Mondex USA Services are not permitted to engage in activities that are not permitted for national banks.

Now, we have no doubt that the soundness and expertise of Mondex USA's equity owners, which include Wells Fargo Bank, MasterCard, Chase Manhattan, AT&T Universal Bank Corp., First Chicago NBD, Michigan National Bank, and Dean Witter Discovery Company have had a substantial impact on the decision of our regulators to authorize the investment by these national banks in Mondex USA.

Likewise, as equity owners, as prudent commercial organizations, both banks and non-banks alike, in licensing financial service organizations to act as issuers and redeemers of Mondex value, Mondex USA plans to critically evaluate the financial condition and stability of each organization that is licensed because ultimately the strength of Mondex lies in its double safety net of consumer protection.

First and foremost is the pool of assets that we hold for investment in short-term U.S. government securities that I referred to earlier. That is at least 100 percent of the dollar amount of Mondex value sold.

Secondly, in the unlikely event of any kind of failure of the Originator itself, every Mondex USA licensed card issuer is also contractually required to redeem at face value all valid Mondex value presented by its card holders.

Now, Mondex cards will in some circumstances be co-branded with the logos of national, regional, and local merchants. However, those merchants are not expected to be issuers or redeemers of Mondex value.

Rather, those merchants will simply accept Mondex value in payment for goods or services and will remit the Mondex value to a participating financial institution that is a licensee of Mondex in exchange for a credit to the merchant's bank account for the U.S. dollar equivalent of the Mondex value that they've redeemed.

In these circumstances, the real backbone of the Mondex system and what gives it its stability are the Originator, which is supervised by the OCC, and the participating financial organizations within the Mondex USA family.

And it is to those entities that consumers can count on and look for reimbursement and protection with respect to their

Mondex value.

CHAIRMAN LUDWIG: Thank you very much. Ms. Shields.

MS. SHIELDS: Thank you for inviting me today. I represent consumer interests in some of the areas in electronic banking. When we're looking at who the issuers might be, our key concerns are the protection of consumers.

So, some of the questions in particular that I think are important and have been important in the past when we've looked at other non-cash type payment systems, first, of course, what has been discussed already, "Will the consumer's money be safe?"

I think a lot of concern on the part of consumers about purchases on the Internet has slowed the development of the Internet for commerce.

Also, in the area of stored value or smart cards, consumers are going to need to know that when they go to use these cards, the money will be there on the card or in the account depending on how it's set up.

Secondly, what is the consumer's liability for any losses that are incurred? We are quite concerned about any limits on losses for unauthorized transactions.

In fact, the General Counsel of the FDIC issued an opinion letter last summer suggesting that in most cases stored value cards would not be protected by deposit insurance.

Third, will consumer's privacy be protected? This is a particular problem. We're concerned that this information can be collected in some sort of centralized database and that information then used and sold and help people to generate profits while invading consumer privacy.

Fourth, will consumers be able to convert electronic money to cash? We have heard some stories of people having a lot of difficulty after the Olympic experiment in being able to convert any money left on the cards back into cash.

So, we want to make sure that it would be possible to make this conversion from the card back to cash. A lot of the proponents for the smart cards and stored value cards are saying these are the same as cash or better than cash.

Well, if that's the case, then they should be always convertible to cash. Fifth, will consumers have access to the electronic payment systems? We think generally that the performance of banks in especially low-income areas has been rather dismal.

So, that it's very important that consumers in low-income neighborhoods, especially these consumers who will depend on electronic benefits transfers have access to the electronics payment system at a fair price.

Six, will machines and equipment be user friendly? We've heard some elderly people especially that have problems with using ATMs and don't have computers.

So, this might create some problems for them. Also,

there are general concerns on the part of consumers on whether the terminals may malfunction, and they have all this money on a card but can't buy anything.

Or they can't just look at the card like they can open their wallet and see how much money they have. They have to have a card reader.

Will the consumers be able to use electronic money in a variety of establishments? We've also heard consumer concerns that they would have to have a number of different cards for all different issuers and card readers in the different stores.

Right now, I have a whole wallet full of copy cards for all the various universities and libraries throughout D.C. because everyone has a different machine and a different system.

How much will the electronic money cost consumers? This is a real concern and another area where the people say electronic money is the same as cash or better than cash.

Well, we've heard though a lot of plans on the part of the banking industry or the card issuer industry to charge fees for loading money onto the cards, charge fees when the cards are used.

We saw what we fear might happen in electronic banking including the home computer and the smart cards with ATMs where ATMs were originally introduced free, and then they started charging office fees.

And now, we're seeing card fees and surcharges. So, we'd hate to see this as just one more big profit center for the banks rather than a focus on the consumer.

Ninth, will the disclosures to consumers be adequate? We are particularly concerned with the disclosures that were proposed, or the exemptions more specifically, that were proposed by the Federal Reserve Board earlier.

We would like to make sure that consumers do understand things like their liability for unauthorized transfers, what to do if the machine malfunctions and destroys their card and things like that.

And finally, will regulations be developed to protect consumers? I've been to a number of industry and agency conferences on this issue.

And I'm very concerned with what seems to be a lot of pressure on the part of industry to discourage the development of regulation in this area and say that the free market should just be allowed to develop without so much protection of consumers here from government.

So, I also then have some suggestions for some regulations of smart cards and stored value systems. And I also see that Margot Saunders and Mark Budnitz also have a proposed law.

So, I won't spend a lot of time on this. Particularly, I'm concerned with adequate disclosure so that the consumers expectations match reality and maintaining consumer privacy in

the use of the electronic payment system. Thank you.

CHAIRMAN LUDWIG: Thank you very much, Ms. Shields. I appreciate it. Let me start if I might with one question that really comes out of this morning's panel which a number of you touched on, really one of the fundamental topics of this first panel this afternoon.

And that is, the financial well-being, the solvency of the issuer. This morning there seemed to be some coalescence around the notion, it's surprising, that not only is this a big issue, but that it was an issue if there were to be any kind of rules, this is an area in which one ought to focus attention.

And I think it goes too far to say people are calling, everyone was calling, for a statute in this area. But there was some coalescence around the notion this was important.

A question which I know -- I think I know where Mr. Levine is because it was the subject of his testimony, but I'd be interested in other's views. Are the state money transmitter laws enough?

And if they are not enough, where do you think they fall short? And what kind of solvency rules should one move to or think about for issuers of stored value? Mr. Levine, I'll begin with you, although I think I know your views.

MR. LEVINE: Yes, I guess my views on the subject are clear. But let me just indicate and reemphasize that the most modern of state laws operate this way.

There's a minimum net worth and a bond requirement. There's a permissible investment requirement which is much like what Mark Plotkin was talking about in describing the Mondex practice, which as I indicated earlier is a dollar for dollar balancing of a reserve fund against the outstandings.

Now, the most modern of states, however, have also come up with additional features. The additional features include a statutory trust.

Because obviously that group of permissible investments isn't any good if the receiver in bankruptcy, and God forbid you've got bankruptcy, if the receiver in bankruptcy is able to take that pool of funds and apply them to general creditors, the landlord, the person who supplies the automobile leases, whatever.

A statutory trust basically says there's a lot of federal law, although not all the circuits have looked at it. But those that have are consistent say that if the state legislature or the federal legislature, the Congress, creates a trust, in effect an intent, that a certain pool of money is to be used on behalf of a certain group of beneficiaries in the case of a bankruptcy that the bankruptcy trustee must honor that trust.

And so, we like it of course as a licensee because it costs you nothing. The states like it because they don't have to administer anything.

And yet, the legal hook is there to go to the trustee

in bankruptcy at the time, God forbid, of a bankruptcy and say, "Hey, wait a minute. That money, that pool of assets, is there for the holders of the instruments only."

And that's the latest development. So, I think that scheme is actually pretty good.

CHAIRMAN LUDWIG: How many states have that scheme?

MR. LEVINE: Now, three, and it's in the model law. So, it's in the bill in Massachusetts right now and New Jersey. So, it would be five at the end of this legislative year.

CHAIRMAN LUDWIG: Do you want to follow up?

GOVERNOR KELLEY: Yes. This model law you referred to, where is it and what are its prospects? And would we have a common body of law effectively across the country if that got adopted by all states?

MR. LEVINE: Yes, we would. There are approximately six states that have it now. Out of the 45, there will be two more, three more at the end of this year because Maine just passed it about three weeks ago.

And more of the states are similar, even without the model than they are dissimilar. What the model does is to pull together the best of what's out there as well as add some of these new features like statutory trust.

GOVERNOR KELLEY: I'll take it that it would pull together the best of all the features. But what are the prospects of getting there in 50 states?

MR. LEVINE: The prospects of getting there in 50 states are probably pretty good over the next five to six years. But as a practical matter, as I indicated before, it really only has to happen in the majority of big states.

And when I say big, I mean populace industrial states for a lot of reasons. Mainly that you can't have a company that's a commercial success if it's only based, and I don't want to disparage any one particular state, in a state that has more buffalo than people.

I mean, it just isn't going to work. You've got to be in the states whether it's regional, say southeast Florida, or in the northeast, New York, Connecticut, Massachusetts.

Or in the west, California, Washington, or the Rocky Mountain states, Colorado. You have to be in one of those states really to make a go of it.

CHAIRMAN LUDWIG: Mr. Lewis? Our pattern this morning is to go around the table.

MR. LEWIS: You want me to follow a Washington lawyer talking about the law? I'll make a stab at it. I was familiar with the regional money order company that went bankrupt.

It wasn't regulated by the state bank department. It was regulated by the state security department. And the people that lost all their money in that were the individuals.

All of the losses went back down to the people buying money orders that were paying their utility bills and so forth.

Yet, at the same time, I'm a proponent of the dual banking system.

So, I recognize that. I would like to probably make the distinction in the type of instruments where Mr. Levine brought up earlier that there could be a distinction between a money order, a traveler's check, and an electronic payment on the Internet.

There may be some distinction on jurisdiction in regard to not only the sophistication of the product, but where the final payment winds up.

CHAIRMAN LUDWIG: Thank you. Mr. Norwood?

MR. NORWOOD: I'm sure I second everything Mr. Levine said if I understood all of it. But long story short, basically is that today our funds are secured by the state university system that we operate under in Florida.

As we work with other universities, we are facing these exact legal issues you're debating right now with several of those today say how do we know that the funds on deposit will be available in case you're no longer in business to do business with us?

Who's going to hold the funds pool? And to date, we have resolved that issue with the schools we're working with now by saying simply, "You hold the funds pool. And, therefore, you're assuming the liability since it is 'today' your card that we're issuing with this pre-paid value on that particular card."

And that is sufficing at the moment needless to say. It is not the long-term solution nor do I think it's where the industry wants to go. Interoperability will change that.

If we ever get interoperability, I don't think that will work anymore. And as we move to that open "global" system, I think we will see that.

I think you've also in the last two years experienced a rather radical change in the suppliers in this industry, i.e., the banks have been pursuing financial institutions, pursuing their own venues and what they wanted to do in stored and pre-paid value and smart cards.

Universities and smaller companies have been pursuing what they wanted to do in the smart card arena. And several of those companies are no longer around.

I think luckily none of those have resulted in a "failure" of any of these funds pools to date. They have simply negotiated buy-outs with the universities to get out of the processes they were in.

So, it to date has been successful from that standpoint, but only by luck I think more so than anything else.

CHAIRMAN LUDWIG: Mr. Plotkin?

MR. PLOTKIN: As I said previously, the situation for Mondex as it stands now is that we, through our agreement with the Office of the Comptroller of the Currency, presently hold a pool of 100 percent of our outstanding Mondex value, funds

available to redeem that value in short term U.S. government securities.

We at Mondex wouldn't have any philosophical objection to some kind of uniform requirements under state law that would enable state regulators to be able to reach in on a state-by-state basis and deal with the situation of a bankruptcy or create other kinds of regulations that might help shore up public confidence.

However, right now what we have is we have regulation directly by the OCC. We don't have uniform state statutes. We're frankly concerned about the patchwork quilt of state statutes that are there now and how it might impact on us, particularly in light of the fact that we expect a considerable amount of the Mondex business to be done over the Internet, which others have already mentioned raises much greater questions.

There's a lot more gray area in terms of who has jurisdiction. Because that is unsettled, we're frankly concerned about, just as a practical matter, submitting to state-by-state jurisdiction.

And frankly, it's made federal regulation of our issuing, our originating entity attractive for that reason.

MS. SHIELDS: I think from the consumer standpoint, one area I would disagree with Mark a bit is we're interested in the states being able to pass laws to protect their consumers, laws that the voters in the state have indicated that they support.

We've seen things like no frills bank accounts required in some states. Or we have some efforts in various states to outlaw the surcharge on ATM transactions. So, when you start to talk about a uniform state law, we would also want to see states be able to pass protections for consumers above that law.

MS. BUCK: How often do these states go in and examine these entities? You have a level of regulation, but if they aren't in there checking --

MR. LEVINE: Well, periodically, I get these calls from my clients, and they scream. And I have to put the phone down because they say -- the most recent call was from a household name that you would all know.

And they called, and they screamed last week, and they said, "Ezra, do you know how many state examiners have been here since January?" They had six or seven in as many months as we've had since January.

They usually come in for anywhere from two days to a week. The licensee pays the cost, the reasonable cost, of examination. And they look at books and records just like a bank exam.

And they go carefully through everything. They interview management. They look at revenues. They look at expenses. They look at new business.

But in answer to your question actually, more and more of them. When I started doing this, again about eight years ago,

it was relatively easy to say, yes, three typically did it, California, New York, Pennsylvania.

Now, it's Texas, Florida. I understand Delaware has just joined the fray. You're probably talking anywhere, depending upon the size of the company, anywhere from eight to 12 or 13.

Now, one of the things, of course, we would like as licensees is for the states to get together and delegate one or two who come in together and do it all because it's less burden for us just in terms of disruption of the business, but is quite thorough.

And you do get a full report at the end, a compliance report which says, "Here's what we looked at. Here's how we ranked you. Here are your problems."

And sometimes there are fines. So, depending upon the state, some are gentler than others. Some use it as a revenue bases too. But generally speaking, they're pretty tough. And you can work with them.

And sometimes in fact they really come up with good suggestions, "Gee, you ought to do it this way. You ought to do it that way." Or "By the way, we've seen it done this way at another company."

So, all of that is fairly interesting. It's an interesting process. But more and more of them are doing it. Everybody is beginning to really take it seriously. That is also a new development in the last four or five years.

GOVERNOR KELLEY: Mr. Levine, it sounds like you're making a pretty good argument for federal regulation. So, you don't have to have all those people coming in there.

MR. LEVINE: Well, you know, I balance it. It's sort of the devil that you know. Look, all of my clients complain about regulation.

There's no doubt about it. I suppose we're in the land of free enterprise, and people don't want to be regulated whether it's the Feds or the state.

And what I'm trying to get across to you I suppose about this level of state regulation is it's serious regulation. I often have the feeling, no insult to anybody on this panel, but I often have the feeling that federal regulators generally, particularly federal bank regulators, believe that the regulation of non-banks is kind of this invisible shadowy world of smoke and mirrors where nothing really happens.

And I must admit when I found out about this ten years ago or so in the context of a cross claim in an antitrust case, that's what I thought too. I said, "My God, what is this? I never heard of this before. Whoever heard of sale of checks regulation?"

But in fact, it's quite serious. And while on the one hand I suppose it might be nice to have federal regulation that's uniform with one license nationwide. It's not clear who's going

to do that.

Someone actually had a bill to invest the FTC with that a few years ago, and nobody wanted to touch that one. Nobody in Washington did. And I think as companies get used to it, they realize it's more the same than different.

And one of the worst aspects of it, quite frankly, is the multiple exams. On the other hand, through the Money Transmitter Regulators Association, once you get to meet the regulators, informal meetings and get to know the sort of pool of them, it sort of smooths things out.

And it tends to be more the same than different, notwithstanding that it really is 45 different laws to one extent or another.

COMMISSIONER MORRIS: I admitted earlier today that I'm still in the steep part of the learning curve on e-cash. But what would you say is the distinguishing characteristic that distinguishes between redeemable stored value card value and a deposit relationship with a financial institution?

MR. LEVINE: Do you want to address that?

CHAIRMAN LUDWIG: Why don't we go around the panel starting with Mr. Lewis.

MR. LEWIS: That's a legal and accounting question. I really don't know in my own mind as far as the method of operation of the utility of it there somewhere. I'm sure accounting-wise and legal-wise there is a distinction like the FDIC has separated different classes of stored value cards into four separate classes.

But how they look to the consumer looks the same. I mean, if they have a relationship with a commercial bank and they've got some stored value on a card issued by the bank, then that's the relationship with the bank. They feel like they have it on deposit.

MR. NORWOOD: Well, first I want to thank Janice for collecting all the money from the libraries and helping those higher education institutions out, that is, float in their universities somewhere.

And they obviously hope you'll never spend it. So, thank you very much for those opportunities. But in the meantime, it is a problem in the interoperability issue.

And that's what you're more or less relating to there. But again, businesses for years have always sold coupons. They've sold other redeemable things at their merchant locations or specific usable things.

I think this business is targeting that, stadiums, arenas, single issue cards for single events or multiple events. Those types of things are happening.

And whether those cards are clearly defined to the user is one of the real issues of the card holder, i.e., do I know that it expires at the end of that season, and do I know that if I haven't spent all of those funds, they may expire?

Those kinds of things are critical in this process. Going back to the basic question, "Is this a depository relationship?"

COMMISSIONER MORRIS: I think you used that term.

MR. NORWOOD: Well, yes. The question is this. The funds are actually in our world carried on the card. In other words, it is where it is in a sense from the standpoint of accounting functionality.

The stored value and e-purse systems are running down two different tracks right now. One is in a sense unaccountable, and one is accountable. And that's the big discussion that's going on behind the scenes.

An accountable system comes closer to emulating a bank system in reality, i.e., being able to tell what you have on your card exactly the status of that card and what's happening with the balances on your card.

The other systems, typically venues that are one-time issues, may not do that. The card was issued with a \$20 value, and it's decremented straight off the card. And it is not accounted for in any other system anywhere else other than knowing that a single \$20 card was sold.

Those are the real issues. And whether or not they end up being a depository relationship or not, you folks are going to end up telling us anyway.

MR. WEINER: We're clear at least. And I think it differs across the different card systems. I mean, this is where the distinctions between Visa cash and Mondex and American Express and the Proton product, etc., Cyber cash, all become much more distinct.

The way we conceive of Mondex value is that it is not a deposit, that there is not a depository relationship. As Mr. Norwood said, the notion is that of value carried around on the card outside the grasp of a depository institution.

And perhaps the best analogy I can think of is if I were able to take my metro fare card, and I was able to buy not just the fare from Metro Center to Bethesda with it, but I was also able to take it over to the Wall Street Deli and buy a sandwich and buy The Washington Post with it and do a few other things.

I have no illusion that the value on my fare card is a depository relationship. I know it's not. I have withdrawn the money. I have purchased a scrip in effect, a metro scrip, that I then use where I'm able to use it, those merchants who will redeem it.

Now, the only merchant willing to redeem it right now is the Washington Metropolitan Area Transit Authority. But if more merchants are willing to redeem the value on my metro fare card, ultimately that's the world that we envision.

Mondex value -- which is why it approximates cash and why it's very much not like a deposit. As a corollary to that,

one of the reasons why it's sensible to not treat Mondex value as an insurable deposit is because the institutions that sell and redeem Mondex value have no control over that value once it's been passed onto the consumer.

By contrast, when it's on the books of the institution in its general ledger, they're able to maintain reserves. They're able to pay deposit insurance premiums.

They know how much is circulating around and what they're responsible for. Once it leaves the possession of the institution and goes in the consumer's hands, there really is no practical way, feasible way, of maintaining an insured kind of system, at least on the Mondex front. And accordingly, we see it as not a deposit.

MS. SHIELDS: From the consumer view, I think one of the key concerns is what happens if the card is lost, stolen, or destroyed? What happens to the value?

If there's some sort of online system, then the consumer has the ability perhaps to go in and put a hold on that and then get their money back or get a new card. So, there's an advantage to looking at this as a deposit or somehow to track the use of the card and the current balance on the card.

The disadvantage of course is then we have the whole privacy problem with control over flow of information because you have to set up a database.

On one of the 60 Minutes-type programs they had a few weeks ago a story on food stamp cards and how they've been able to use the food stamp database in order to track where some fraud has been occurring and to put a stop to that.

I think that if they can have some sort of centralized database that way for the food stamps, then maybe some cards could be available with that type of database for consumers that would like that type of protection at a reasonable cost to the consumers, if any.

CHAIRMAN LUDWIG: I have an additional question. I'd be interested to know what rights and recourse do consumers have on the various schemes if an issuer goes down and if those rights and that recourse vary? And if so, what degrees do they vary?

MR. LEVINE: If a nonbank issuer goes down, and thank God we haven't had recent experience, normally what has happened under the state laws is that the trustees in bankruptcy have pooled the bonds, the most recent experiences -- let me back up.

The recent experiences come out the way you want them to come out from the standpoint of the consumer and from the standpoint of the state regulators.

What the trustees in bankruptcy have done is to pool the bonds that are posted by the issuer that's now bankrupt for the benefit of the holders. The holders present claims or the banking departments present claims on behalf of the holders.

The holders present their instruments. The instruments get paid off. That's what's been happening. Now, in the case of

Circle K, Circle K was issuing its own instruments.

And that's about six years ago or five years ago. And they went belly up. They were in Chapter 11. So, there was an ongoing business.

One of the major national issuers stepped in and started offering its instruments. In the meantime, the receiver of Circle K which ultimately did emerge as you may know from bankruptcy was able to use the ongoing business of the company plus the bonds to pay off the holders.

So, there have not been major losses as I understand it among money order issuers, the money order or traveler check holders in the United States or money transmitters.

CHAIRMAN LUDWIG: Well, what happens to a holder that doesn't present? In other words, it must be the case that people don't get notice that they're at the end of the line. Do status sheet laws apply?

MR. LEVINE: Yes, status sheet laws do apply to the instruments. And there are different rules for traveler's checks recognizing that those instruments are often held for a longer period.

Many of you may do what I do. Because I travel so much, I keep \$100 in traveler's checks that just sits there in case I lose my wallet. And they've probably been there for 15 years.

But money orders, the turnaround tends to be pretty quick. Same thing on wire transfers. These sheet laws do apply. And I understand with regard to store value cards, that's been a hot topic of interest.

Do the state laws apply and which ones apply? So, luckily there hasn't been that much experience. I'm not trying to dodge your question. There really hasn't been that much experience because there hasn't been that many failures.

There really has not been a big "national failure" where people have lost money in a while in probably longer than six or seven years in the United States.

The laws really do work. I mean, it's an odd circumstance where in fact the laws are getting tougher and it works.

GOVERNOR KELLEY: I'd like to ask Ms. Shields as the consumer spokesperson on this panel what you feel about these common state laws that Mr. Levine is telling us are beginning to be adopted?

MS. SHIELDS: We, of course, want to see the types of laws exist that prevent consumer losses from the issuers going bankrupt. But again, we would also like to know that when the states adopt a model law that if the residents of the state want stronger protections than exist in that law, then that should be permissible as well.

CHAIRMAN LUDWIG: I'd be interested to know what prudential requirements such as capital liquidity apply to the

issuers, what prudential requirements do you think ought to apply?

In other words, do you have any sense of what are the key elements and what parts also of the banking and other laws ought to apply more broadly or apply broadly if any?

MR. LEVINE: Well, certainly the position of the non-bank funds transmitter group has been the same for many years. And that is, to support the model law because one of the essential features, and I think Mr. Plotkin and I kind of agree on this, is that you ought to have a reserve requirement equal to outstandings.

There's got to be, whether you call it permissible investments or reserves or something. You've got to have investments from a menu that the government prescribes whether it's CDS or government obligations as he talked about, whatever.

Things that are generally considered to be safe and sound to match the outstandings. There's got to be a basis of that.

Now, the states all fuss around with minimum net worth requirements. Should it be 100,000? Should it be a million? Should it be three or four million?

Should it be net worth according to gap? Should it be tangible net worth? You can play around with that. They are subjective measures.

I'm not sure to tell you the truth it makes a hell of a lot of difference, except perhaps to be anti-competitive in the sense that you're excluding some smaller upstart businesses that want to get in, are going to be honest, and want to grow.

So, you have to set that at a reasonable requirement. But it seems to me that if the financial statements are reviewed and done and they're audited by a CPA, and they're reviewed by state regulators who are looking for safety and soundness, and if there are these permissible investments matching the outstandings and there's a bond of some reasonable amount, it seems to me then you have created a liquidity situation which is going to protect the consumer.

And by the way, I believe in the sentiments I think behind Ms. Shields' comments. And that is this. Consumers have to be protected.

If nonbanks go down, whether it's in stored value or whether it's in just traditional old low-tech sale of checks, consumer confidence is going to be undermined. It's bad for business. I mean, it really is.

And that's why, frankly, my clients care a lot about this. Because their business is dependent on consumer confidence. They want to make sure that everybody who does this is safe and sound.

So, getting back to the liquidity issue, I think those basic kinds of things coupled with aggressive state regulation or anybody's regulation, meaning supervision, looking at the books

and records, making sure that what's submitted is in fact what's really there.

As one state regulator said to me, "One of the things we want to make sure is that there aren't wheels and tires underneath your office." That it's really there in bricks and mortar and you say it is a computer, it's really there.

Well, that's right. That's why they come. So, yes, I think those kinds of liquidity things frankly do ensure, particularly if coupled with the statutory trust, do protect ultimately the consumer which bottom line that's what any state regulator ought to care about separate and aside from things like money laundering and those kinds of issues.

CHAIRMAN LUDWIG: What kind of instruments should -- do they have a list? They undoubtedly have a list of instruments. They must vary from state to state now in terms of what are the permissible instruments.

MR. LEVINE: Well, normally it will be CDS. It will be cash. It will be bonds, federal bonds issued by the federal government or guaranteed by the federal government or an agency or instrumentality of the federal government.

Sometimes it will be state bonds. Sometimes it will be corporate bonds if they're of a certain classification. Those are the typical things.

MR. HOVE: Is there some sort of a seal of approval to know that they are your clients and they have been certified and approved by some state regulator that sets certain standards other than some outlier who operates sort of in a gray area without any kind of regulation approval?

MR. LEVINE: Are you asking whether there's a certainty?

MR. HOVE: How does the customer know that there is some certainty in knowing who they're dealing with?

MR. LEVINE: Well, that's one of our issues as well. Ultimately, it depends on how aggressive the state is in regulating those issues. Now, most issuers are so visible certainly with regard to paper instruments that the states are either going to find out on their own or, to be quite blunt about it, one of my clients is going to tell them.

It's the old level playing field. You've heard that one before, the level playing field argument. And my clients will pick up the phone just like others who are not my clients pick up the phone and say to the regulators, "By the way, do you know that somebody's out there issuing money orders?"

In some states, for example, there's been a long history of small supermarket chains that take their regular commercial checks that they use to pay for groceries, for potatoes, for example, they have a rubber stamp.

And they stamp money order on them. And they sell them for 50 cents or a buck because that's all the money order costs. And the licensed entities will go to the state and say, "Hey,

wait a minute."

In most states, it's at least a misdemeanor if not a felony for doing that under 18 USC 1960, the so-called D'Amato Amendment to the money laundering law two Congresses ago, Wiley Anunzio money laundering law.

It's a federal felony. And the punishment is potential seizure of assets to operate a money transmitting business without a state license if a state license is required and if it would be a misdemeanor or a felony under state law.

So, there's a terrific risk it seems to me for doing it. Are there people out there doing it? Undoubtedly. There are even some crooked lawyers out there. It's hard to imagine.

MS. BERNSTEIN: Could I follow that up, Gene, please? Do you have any information or does the association have any information on how consumers perceive how secure these institutions are?

MR. LEVINE: Well, we only have anecdotal information from our consumers because our consumers, meaning our customers, keep coming back. And they keep coming back because more and more, and this is not a slap at banks, it is true that there is a huge unwashed, unbanked group of consumers.

There's a great divergence between the rich and the poor. And many American jobs are low paying. Plus some banks are getting expensive. Not his bank. Some other banks are getting expensive.

And as a result, more and more people are using money orders to pay routine bills because it's a cheap way of doing "retail banking" or retail financial services. Let's put it that way.

So, people know that it works. They know the company names. For example, the ones I represent are the big national issuers like Traveler's Express which is the largest in the United States, money order issue.

But you can go in New York and Pennsylvania, there is a very honest, very good multi-state money order company that's had incredible growth rates.

It's run by a huge conglomerate of supermarkets, a supermarket co-op. They do very, very well. Their customers love them. And they're growing because they're known

Now, some of it starts off as advertising. Western Union. Who hasn't heard about Western Union or Moneygram? But I think consumer acceptance is there.

Why? Because if people lose a money order, you call Traveler's Express, and they replace it. If there's a problem, you get a receipt at Western Union. They deal with it.

And hence, the consumer acceptance grows on itself. So, I think anecdotally it's there. Do consumers know it's regulated? I bet not. I bet not.

I mean, is there a sign? Now, some states do require a sign by the way. I should tell you that New York, Wisconsin, and

there are a couple of others. It's a royal pain to make sure that you're selling. Locations do, in fact, post the sign as required by law.

But there are some states like New York that require a sign to be posted at the point of sale saying, "This entity is licensed by the state of New York under an umbrella license to Traveler's Express, etc., etc." under the New York state article 13 of the banking law.

So, Florida is going to do the same thing. They just passed an amendment to their statute to do that. So, some states do that.

Do consumers know that? Generally, I think not. I think these are just sort of institutions, and they expect that a money order is going to be paid. I think that's right.

And I think they have lots of confidence in it. And thank God it works because of the state regulators, but I don't think one percent of them know there are these statutes.

I didn't know there were these statutes. And I suspect most people in this room didn't know that until they walked in here.

MR. OLIVER: Is it clear that pre-paid cards and stuff like that fall under these statutes?

MR. LEVINE: Well, the Texas Department of Banking certainly thinks so. They've taken the position that a pre-paid card by a non-bank in an open environment is absolutely covered by it.

Two of my clients have recently written to all 45 states and said, "Gee, we want to issue a smart card version of a traveler's check."

And the response in the overwhelming number of states was, "Yep. If it's a stored value card and it's an open system, we're going to consider it an instrument for the transmission of funds." Because after all, that's the definition of a check.

It doesn't have to be a writing on a piece of paper. It just has to be an instrument for the transmission of funds. Now, did anybody think smart card when that language was developed? No.

MR. OLIVER: They don't have to write to the other five though. Right?

MR. LEVINE: Right.

CHAIRMAN LUDWIG: I'll turn the question around a little bit. This is precisely the subject of this panel. I'd be kind of interested in -- what happens when the consumer loses the instrument?

You've given some, it's clear in my mind, some instances where in terms of some companies' practices the consumer is able to obtain his or her money back by way of use of a receipt or some other evidence of payment.

Is that the uniform practice? Should it be the uniform practice? And as to the other, I'd be kind of interested, as I

was beginning to ask Mr. Norwood this morning, what happens when a student loses his or her card?

And perhaps we might go around as to what the right practice ought to be.

MR. LEVINE: Well, certainly with money orders, it's replacement. Traveler's checks, it's replacement. The customer always gets a receipt. It's a carbon copy.

For example, Traveler's Express money orders it's a carbon copy. You fill it out. You send it to pay your rent or your car payment. You have a copy of the check.

So, hopefully you hold onto that. Money transmission would say Western Union or Moneygram. You have a receipt at the point of transmission. So, there is a way to deal with lost or stolen instrument.

And that's typical. I should also add that money orders issued by nonbanks, and I meant to raise this before, money orders issued by nonbanks are very often sold at depository institutions.

Because third party instruments, again, I don't know if it's true at Mr. Lewis' bank, but often, for example, First Data which is the parent of Western Union sells its official checks at depository institutions.

CHAIRMAN LUDWIG: Is that required? And is it uniform? And if so, how long does it take? Because if I were to get a receipt from a money order, I would assume the company would want to know the money order isn't floating out there and has been exercised. I just don't know how it works.

MR. LEVINE: Well, normally, the customer fills out a form with the receipt and deals with the company directly. They go to the sales agent. The sales agent gives them an 800 number.

There's actually an 800 number right on the check usually. They call the 800 number and get instructions and are told what to do. They fill out the form, send it in. They'll get a replacement back.

CHAIRMAN LUDWIG: Is that uniform? Is it required by law?

MR. LEVINE: No, it's not required by law. This has grown up as a matter of practice in the industry. It seems to work.

CHAIRMAN LUDWIG: Is that something you'd expect to see or want to see in terms of stored value cards which is what if the customer loses a stored value card?

MR. LEVINE: Well, I think you need to deal with some procedure with that, or you need to tell the customer up front, "Here's what happens if you lose your card."

I think the subway card, if we're talking about the MTA subway card before, I think the subway card does say something on it. But it depends on what consumer expectation is.

CHAIRMAN LUDWIG: But that would not be required by law?

MR. LEVINE: No.

CHAIRMAN LUDWIG: Under the uniform law?

MR. LEVINE: Correct.

CHAIRMAN LUDWIG: If you lost your card under the uniform law, you would just be dependent upon your relationship with the individual issuer?

MR. LEVINE: That's correct. Absolutely.

CHAIRMAN LUDWIG: Mr. Lewis?

MR. LEWIS: I don't know what I can add to that except in my dealing with these bank products, we fall under the consumer protection act. So, it's pretty regulated activity as far as loss and so forth.

CHAIRMAN LUDWIG: Mr. Norwood, what happens when a student loses a card?

MR. NORWOOD: Actually, we issue more than one type of card. So, I think that's one thing I'd like to clarify real quick. We currently have three levels of cards in our system at Florida State University in the system we're promoting now.

Basically, a disposable card which is a non-rechargeable item that can have up to, our current limits are \$50. So, that card can have \$50 in value, but I can't tell who purchased the card.

I know nothing about the individual. It may be dispensed out of machines, i.e., like subway passes and everything else. So, therefore, those cards are not trackable, are not able to tell anything about them other than I can track the transactions running through the card.

As the system has more and more readers up, it becomes an impossible task to turn that card off, i.e., if somebody came in said I lost this disposable card, I can tell that from --

Well, I really couldn't even tell if the person lost that card because it's not registered to the individual. But they could say they had lost a card, but I'd have no way to track the card to that individual.

Therefore, I can't stop it. In a sense, it would continue to be spent down. Those cards are typically heavily used in what we call unattended devices, i.e., copiers, washers, dryers, snacks, cokes, and those kinds of things.

And that's their focus in life, the small value transactions. Not the \$30, \$40, \$50 type of activity at all.

The next level cards are the p-cost cards we're using today are totally trackable by individual, registered to an individual, and maintain a balance within our CMS system to let us know who's using the card, where they're using it, and what kind of activities are going on within the card.

Both debits and credits to the card are trackable, i.e., we try to mimic as much as we could the existing banking system so that it would have the audit trails on the backside if they were ever required and the other things that go with that so that we could do those types of activities as well.

Those cards are used at two types of locations, unattended and attended locations. Cokes, snacks, washers, and dryers, not knowing who's putting the card in.

But then the attended merchants across the street selling food and other things that are actually taking your card, looking at a picture on it, and also requiring a PIN number to go into that card access device as well to authenticate you to the card.

Our agreement that we are rewriting as we speak with the card holder side basically says they're liable for up to \$20 of loss on their card. And at that time, a feature within the card called spend limit kicks in and stops any expenditures above that without a verification that you're still the original card holder.

So, our intent is to work with the consumer to protect them for up to \$20 of the value on their card.

MR. PLOTKIN: I think it becomes apparent just through the questions and answers around the panel that full refundability in the event of the loss of a stored value card goes hand in hand with the ability of the issuer to guard against unauthorized use.

As the Comptroller said or asked in his question earlier, you would expect going to a money order issuer with your receipt and seeking replacement of a lost money order that the issuer would want to make sure that the instrument isn't floating around out there and possibly being exercised.

In the circumstances of Mondex, Mondex is designed, the technology has been designed purposefully off-line. And is not designed to track all transactions.

It's only through that kind of technology that Mondex is able to be as convenient for consumers and be the type of product that it's designed to be to enable a customer to customer transaction or for me to use the Mondex card to buy a hot dog from a vendor at the stadium without the vendor having a telecommunications capability or the ability to get on a bus and pay for my fare with exact change rather than having to have a telecommunication with some kind of authorizing central office.

When we think of Mondex, and this is the way we positioned the product, and we intend to make sure that consumers understand this when they purchase the product, that it's the same as if when you lose a \$20 bill.

You don't go to the federal government and expect replacement of the \$20 bill because the federal government has no idea whether you really spent the \$20 bill or truly lost it.

And that's the way it is, and that's exactly how Mondex as a product is designed to be. We expect that if consumers want a product that can be replaced under any circumstances, even when it's lost, then they will pay the cost in terms of reduced convenience and probably higher costs, higher prices for the authorization and telecommunication infrastructure that's

required to accomplish that.

But that's not this product. This product is supposed to be like cash.

CHAIRMAN LUDWIG: Ms. Shields, do you have any views?

MS. SHIELDS: Well, I think it is essential that the consumers know what happens if they lose the card or if anything else happens to the card, whether it's destroyed by a machine.

And clearly, that's going to be different because losing a card, they might have some control over. If it gets destroyed by the machine or the merchant hits \$500 instead of \$5, and they happened to have that much money on the card, that's not really the consumer's fault.

And how are they going to resolve that type of problem? So, there are a lot of potential losses besides just the consumer of it falling out of their wallet.

So, I think we have to be concerned with protection of all those kinds of losses, not just consumer-caused losses.

MR. PLOTKIN: If I could follow up? Ms. Shields is perfectly right about that. I mean, there are multiple kinds of losses. And the one loss I was addressing was the complete loss or theft of the card.

Our expectation is that if one still has the card, no matter what kind of condition the card is in, Mondex has the technology to determine one way or another what kind of value is on that card and to make sure that the consumer is reimbursed or made whole somehow, somehow.

And we'll make that clear in our disclosures as well. But I completely agree that (a) consumers will need to be educated, and (b) when it's not a matter of having lost the card, then certainly a consumer should not be deprived of their value if there is anyway to restore it at all. And our technology permits us to do that.

MR. OLIVER: One question in the Internet environment. We haven't talked much in this session about the Internet environment.

But if people are acquiring services in the Internet environment obviously across state lines in an open atmosphere, then some states are not regulated. Some obviously have varying types of regulation.

And I'm not even sure where that service is being offered since the consumer is dialing in to get it. Are the laws broad enough in the states that have them that using the service in the state is the controlling factor that would subject that remote company to your state laws?

Or is that just a situation that perhaps is not covered adequately right now?

MR. LEVINE: As a lawyer, I can make a real decent argument I think that the states that have money transmission laws, that is where the law is broad enough to encompass funds transmission by electronic or other means, which are typically

the words that are used.

Assuming you can get over the legal nexus issue and presumably those states that are after or trying to prosecute gambling violations or alleged gambling violations over the Internet have at least gotten to that threshold or believe they have.

I think you can make a good argument that those state laws would apply. Have any of the states done it? No. I mean, we've looked at this issue generally. And frankly, we're unsure of that one.

That one's a hard one. And as I said, as a lawyer, I could make the argument. But we haven't made the argument as a group only because we think it's kind of premature at this time.

And that in particular may very well be the case where the federal government should and, in fact, has a duty to do something in terms of -- Mark Plotkin's nodding, duty to do something because in fact maybe it doesn't lend itself to state-by-state regulation.

Although I should add that the state model is actually not a bad one in terms of the basic level of bonding, permissible investments, having somebody who's an examiner come around once in a while, look at books and records.

Even if they're in Liechtenstein, it doesn't matter. If they're doing business in the United States, they ought to be safe and sound. Because I think that's what Americans demand.

And that's what Americans want. And if they're non-banks offering services where they're taking money of third parties and they could go under with your money, then they ought to be regulated for safety and soundness.

But how one goes about this I'm not quite sure. Although, I can see certain models and certain examples, as I've indicated, on the state level. In answer to your question, Mr. Oliver, no state has done it yet. They could.

I mean, they seem to be preoccupied and NEAC seems to be preoccupied with gambling right now.

CHAIRMAN LUDWIG: Mr. Norwood, you were going to say something?

MR. NORWOOD: Just a brief follow up to Mark's earlier comments. Number one, our cards are not online, Mark. I mean, you were referring to smart cards online. They're not.

And we track all those transactions without being online. And I have some cards that our students have brought back. I'd love to see if you can put them back together.

I mean, they come in in bits and pieces and shreds. Their dogs chew them up. And if your company can sort out those chips, you'll be a great company.

But ultimately, it will be a problem. I'll tell you that now. They come back in pieces, not in just a card that doesn't work.

MR. NORWOOD: Well, that would be some of the better

things. But anyway --

MR. PLOTKIN: I knew as soon as I said it, that I was going to eat my words within a few minutes.

CHAIRMAN LUDWIG: Sounds like somebody else is eating, but they're eating cards. Are there any other questions? Well, I want to thank the panelists for a very good panel.

I know we all learned a lot, very valuable information shared. We very much appreciate your time coming a considerable distance to be with us today.

CHAIRMAN LUDWIG: Our final panel of the day will focus on the issues of access. Here we have these exciting new technologies.

And I think there is a genuine issue here. And I think a focus of the panelists to determine the degree to which these new technologies can be helpful or harmful to low and moderate-income Americans to the extent that they have the potential if increasing access to broader financial service environment or could hinder it.

And we're eager today to hear from our panelists. We have an excellent panel assembled to discuss these very important issues.

Marcy Creque is the Legislative Counsel Member and Regional Volunteer Director of the American Association of Retired Persons. Don Graves, Jr. is Vice President for Policy and Programs and the Director of the Washington Office of the Organization for New Equality. ONE is the acronym.

John Harshaw is the Regulatory and Legislative Director of the National Community Reinvestment Coalition. Steve Zeisel, is the Vice President and Senior Counsel for the Consumer Bankers Association.

We have asked our panelists to speak for about five minutes, so we have plenty of time for questions.

We look forward to your remarks. As we've done this morning, we'll proceed this way. And so, we'll begin with Ms. Creque.

MS. CREQUE: Mr. Chairman and members of the task force, AARP appreciates this opportunity to present our views on issues posed by the emergence of new electronic money technologies that affect consumers.

My name is Marcy Creque. And I'm a Regional Volunteer Director for AARP's midwest region. On behalf of the association, thank you for inviting us to participate in this important forum.

The degree of access to and utilization of electronic money technologies by the older population will depend on a number of factors.

These include the ability of these new payment systems to meet specific needs of older persons, the level of confidence that older persons develop in the safety, security, and financial

soundness of these systems, government actions to assure minimum levels of consumer protection, and access to the nation's financial system, and consumer education regarding these new technologies and their potential benefits.

Research shows that the elderly are more cautious and seek a greater certainty than young persons before they adopt a new product or service. Many innovations fail to be used because they are incompatible with the physical abilities of older persons.

For example, utilization of automatic teller machines or ATMs by persons aged 65 and older is half of that of persons 35 and younger. While many younger persons like the convenience of ATMs, failing eyesight and the ability to stand in long lines makes it difficult for many older persons to use them.

Conversion of many branches to all TM services adds to these difficulties. The design of the ATM machines may also contribute to a low utilization rate by older persons.

Researchers at Georgia Tech tested more than 1,500 older adults who had never used ATMs and found that that group made correct choices only 20 percent of the time.

Finally, fear of crime and a perception of vulnerability may also contribute to a low rate of utilization of ATMs by older persons. Regulators can play an important role in ensuring access to and encouraging the development of electronic money technologies.

Consumer protections must be put in place and steps taken to ensure the integrity of these systems. Further, universal access should be promoted through the provision of minimal level accounts that could serve currently unbanked populations.

Proposals to exempt stored value cards or SVCs with values under \$100 from requirements of Regulation E could harm many older persons. Similarly, the security of information generated by these new technologies is a concern.

The elderly are frequent targets of financial scams and abuse. Who will ensure that marketing information generated by these service innovations does not end up in the hands of unscrupulous telemarketers?

The wide acceptance of direct deposit by Social Security recipients and a rising use of home computers suggests that older persons are not adverse to new technology if it meets their needs.

However, unlike younger people, older persons will not buy products simply because they are new. A number of technologies might be considered by the public and private sectors to demonstrate the value of electronic technologies to the older populations.

Opt out provisions might be provided to purchasers of SVCs and other technologies so they can avoid telemarketing and junk mail solicitation. The federal and state governments can

extend and improve safety and soundness requirements for issuers to increase the confidence of the consumer.

They can also restrict unfair fees and charges. Finally, consumer education efforts should be expanded to help the older population understand and gain access to these new technologies.

AARP believes that building trust on the part of the older consumers based on enforceable protections is the key to encouraging the adoption of new electronic money technologies. Thank you.

CHAIRMAN LUDWIG: Thank you very much. Mr. Graves?

MR. GRAVES: Thank you, Mr. Chairman and members of the task force. To begin my testimony, I wish to offer a story of a not too distant future.

Dawn creeps through the windows of a house. Logging onto his personal computer, a young executive instructs his bank to pay bills, checks on his investments, and contemplates an online car loan application.

His wife calls. Away on a business trip, she has just transferred cash via laptop computer from the family savings to their checking account.

His son charges in, late for school, and bellowing about lunch money. Dad grabs the boy's smart card and swipes it through a card reader in his PC to download electronic cash from his bank account onto the card.

In a totally different, yet equally possible scenario, dusk descends upon a city street. A mother trudges the ten blocks to the nearest grocery store to buy food for her children.

At the store's checkout aisle, the mother opens her purse to get the money needed to pay for the food, bringing out a few bills. The clerk abruptly declares, "I'm sorry, ma'am, we don't take cash here anymore. Only smart cards, debit cards, or credit cards."

The woman shocked by the young clerk's statement thinks to herself, "But I don't have any of those cards because I don't have a bank account." The mother tells the clerk, "Oh, I'm sorry, I left my wallet at home."

And she places the food back on the shelves leaving the store quickly. As the mother walks home, she passes the check cashing store where she had just cashed her own paycheck and her mother's social security check.

Though by law checks were supposed to be by electronic payments to a person's bank account as of January 1, 1999, she and her mother obtained waivers because they did not have bank accounts and did not know how to access their funds electronically.

As we have seen recently, the greater use of electronic technologies in banking has moved from mere theory to actual reality or, if you will, virtual reality.

Much of this has been driven by the consolidation

within the financial services industry through mergers and acquisitions and by the cost benefits gained by those institutions making the transition to an increased reliance on electronic technology in the provision of services.

Time and economics will continue to push institutions toward new and innovative ways of providing services to the public. Therefore, it behooves us to evaluate these radical changes in how people bank and do business from all perspectives at this critical stepping off point.

Since 1990, we have made tremendous progress in facilitating greater access to financial services for low and moderate-income communities. Bank branches have relocated in communities from which they have been absent for generations.

We have seen banks develop affordable mortgage products and flexible underwriting criteria which have resulted in an explosion of first-time home buyers in these same communities.

The locations of ATMs in these communities has also given low and moderate-income people unprecedented access to their money and financial services. Yet, there are tens of millions of people in this country who are either unbanked or underbanked.

It is our task, regulators, bankers, as well as those who represent consumers to ensure that low and moderate-income individuals have expanded access to credit and capital, keeping up with the current in such a changing environment.

While there is great potential if gone about in a careful and intelligent manner, the implications of electronic banking and technologies could pose a serious risk of further disenfranchising and excluding historically underserved communities.

The lack of access to, as well as experience with, computers, ATMs, and the like, will limit their use by low and moderate-income users.

In any discussion of people's access to electronic technologies, we must not only discuss a person's ability to physically access the services and technologies, whether that be ATMs, ALMs, computers, stored value cards, or others, but we must also discuss that same individual's base of knowledge, experience, and comfort level with such technologies.

Not only whether an individual may be able to afford to use these new technologies and services, but whether the financial industry or this nation in general can afford not to bring those in the economic wasteland into the economic mainstream by finding ways of ensuring access.

Access to electronic and computer technologies for low and moderate-income communities will continue to be an area of concern given that the ability to obtain access, at least initially, is driven by the amount of disposable income the individual consumer may have.

Therefore, access for low and moderate-income

individuals is going to be significantly impacted by the amount of fees charged for such services.

Assuming that banks have the primary franchise for electronic banking, the fee structure of such should be developed in a way that deals not only with the cost to the banks for providing such services, but also takes into account the cost savings realized by the bank, or the government in the case of EFT-99, as well as the hardships it will impose upon all of the bank's customers and upon potential customers.

In numerous studies, it has been shown that there is a direct and inverse correlation between the size of fees charged to consumers for services and the amount of access afforded low and moderate-income individuals.

The way we mitigate against the underserved being put in a ghetto in a separate financial system guaranteeing access to electronic payment systems is to keep banks central to the delivery of financial services to low and moderate-income communities.

This is particularly relevant regarding the matter of stored value cards. Aside from specialty cards such as phone cards or mass transit cards, the franchise to issue general cash cards should be the sole province of banks.

The position makes sound sense for a number of reasons. First of all, banks are located in most communities. And where they are not present, this would continue the momentum to locate banks in underserved communities.

Secondly, because the system is in place to ensure deposits, the question of the integrity of stored value cards is resolved because they could be insured by the FDIC just as other deposited funds are insured.

Third, banks already issue credit and debit cards. And they have in place a process, an infrastructure, to issue stored value cards in the most cost-effective manner for themselves and consumers.

Fourth, allowing banks to have the primary franchise for these new technologies will prevent the need for the creation of a new regulatory system for electronic payments, as the current system could simply be modified to encompass changes.

Perhaps the most important component of any effective solution to the problem of a lack of access to banking services is education and training.

While the new technologies can profoundly impact on bank communities positively, none of their benefits can be realized without first establishing programs to inform and educate low and moderate-income consumers about these alternatives.

The need for education begins with children attending our nation's public schools. You will no doubt find that the great number of those who have attended public schools in this country over the past 20 years and those who are currently

attending public schools are severely undereducated in the arena of economic and financial skills.

Without a background in basic money management, we are turning out adults who are, in effect, economically illiterate.

The changes in the nation's banking system and delivery of services have the potential to break down the barriers to access and reverse the damaging effects of economic illiteracy that continue to plague this nation.

However, without a redevelopment of financial training programs and the provision of a basic financial knowledge as an antecedent to the vast changes on the horizon of the banking world, none of the positive effects of the electronic payment systems will ever be realized for a large segment of that population.

A specialized curriculum must also be developed to teach consumers, be they children, generation Xers, baby boomers, or seniors, how to use the new technologies from ATMs and telephone banking to smart cards and PC banking.

This curriculum which may be administered through the nation's school systems, the social services system, churches, community-based organizations, as well as through innovative programs and materials delivered by financial institutions, must be instituted to ease consumer's transition to electronic payment systems.

Particular attention must be paid to the large portion of seniors who may have had little experience with the newer technologies and have a relatively low comfort level in dealing with these changes as compared to younger consumers.

Technology will increasingly determine the character and quality of life for people as we move into the next century. It is important to recognize the fact that an electronic and computer revolution is sweeping through our nation, its industries and its homes and that without action, the gap between the haves and the have nots and the banks and the unbanked will soon be insurmountable.

In implementing new technologies and networks and in moving away from traditional means of providing services and conducting business, those who have traditionally had training, experience, and access are at a distinct advantage over those who do not. It is up to us from preventing this from happening. Thank you.

CHAIRMAN LUDWIG: Thank you very much. Mr. Harshaw?

MR. HARSHAW: Mr. Chairman, thanks again for inviting us over. As many of you know, the National Community Reinvestment Coalition, or NCRC as it's known, is a national coalition made up of over 620 national community-based, non-profit organizations, some of which are churches and in some other cases, local jurisdictions.

As stored value systems proliferate across the economic landscape, many critical decisions await legislatures,

regulators, issuers, and consumers.

With magnetic strip cards being easily manipulated by criminals and with the development of hardware standards for stored chip devices being several years away, many hurdles await us.

Most of the marketing for SVCs has been to low and moderate-income consumers. There is already an excellent program marketed to homeless veterans to deliver veteran benefits by using ATMs.

The New York transit system with a broad cross section of high and low-income, multi-ethnic, young and elderly users marketed its SVC successfully to merchants along the transit routes only to be blocked out by their redemption financial institution.

We already see examples of public housing authorities installing terminals for tenants to pay their rent. The potential and opportunities to reach every segment of the population with SVC technology is enormous.

How SVCs are marketed is a major concern to consumers. What is acute, however, to rural, low and moderate-income, Native American minority communities is their ability to create jobs and to retain and grow the businesses within those communities.

Access to the end use of SVCs is critical. Point of sale terminals for businesses in these communities are mandatory and allows these businesses to compete with other outside enterprises for the consumer stored value currency.

Otherwise, funds will leave the community with the many issuers leaving IOUs and no circulation of purchase and value. Point of sale terminals are less expensive than ATMs, average price of about \$50.

There is already a precedent for using federal taxing authority to deliver the necessary hardware to rural, non-traditional markets. Utility companies were taxed and the revenues were used to build necessary equipment in all areas of the United States.

Likewise, federal taxes should be applied to financial institutions and other issuers so that the subsidies can be generated for installing point of sale terminals at small businesses serving distressed neighborhoods.

Lenders covered by CRA should receive CRA credit for installing these point of sale terminals. Tax the system to expand in-use opportunities for businesses and service providers in targeted communities.

We all know that security and trust are two of the key factors in developing technology. Growth of SVC technology and usage depends heavily on the confidence and trust of the consumer.

We have already experienced the horror stories of insolvent issuers, leaving both corporations and consumers holding worthless cards.

I am encouraged today by the testimony of Mr. Levine because it seems to us that because SVCs are relatively new that we should seize upon this opportunity to either have SVC insurance funds where insurers would pay premiums based on the amount of stored value liabilities issued.

I was also encouraged by Mr. Levine's testimony that the bonding is at 100 percent. And when you think about it, as he stated, financial institutions only carry a ten percent reserve requirement.

And in some cases, the rest of the money is loaned out the door. So, there's not 100 percent backing those funds.

Proper regulatory enforcement criteria should be established by the appropriate authority yet to be determined. The other most crucial need for consumers is education about SVC.

The marketplace has learned that the best customer is an educated customer. The many risk and opportunities associated with SVCs must be a part of an ongoing curriculum targeted to inner city, rural, and Native American communities.

Videos for the illiterate, multi-lingual instruction materials need to be developed. Low-income and minority merchants need to be educated on security and implementation issues related to SVCs.

NCRC has membership nationwide, and its associates are uniquely prepared to implement an extensive SVC educational project.

With the broad spectrum of members from community-based non-profit organizations to churches, NCRC has a wealth of experience delivering technical assistance and education to underserved and unserved communities. Thank you.

CHAIRMAN LUDWIG: Thank you very much. Mr. Zeisel?

MR. ZEISEL: Thank you, Mr. Chairman and members of the task force. My name is Steve Zeisel. I'm the Senior Counsel for the Consumer Bankers Association.

We really appreciate the opportunity to present the association's views on access to consumer electronic payments. And we commend you for holding these hearings.

CBA's community reinvestment committee has taken a leadership role in the areas of consumer access to financial products and services for many years. We have also created an alternative retail delivery committee to develop policy on issues affecting these new delivery systems.

Needless to say, they are beginning to work together more closely on issues of mutual interest. Electronic banking and alternative means of delivering banking services encompass a wide range of technologies, some of them obviously quite mature, such as ATMs, point of sale, telephone banking and others.

But some are in their infancy such as these Internet and other home banking technologies and stored value cards. Regardless of the vehicle, however, we believe these technologies can be expected to increase the access to and the availability of

banking services in many ways.

We believe the advantages of these alternative delivery mechanisms will be felt by everyone in the bank's communities.

It is already apparent, for example, that the availability of telephone banking makes possible a wide range of services including bill payment, account transfer, balance information, loan applications directly from home, in most cases, around the clock.

ATMs and point of sale terminals provide additional versatility without the need to visit a branch. These technologies make it possible to take the bank to the customer in effect, rather than requiring the customer to come to the bank.

The opportunities that that provides for access to the elderly, to anyone in a community who might have difficulty accessing a branch is apparent.

Stored value cards and home banking are still in the developmental stages, but promise to provide still more versatility. Access has been expanded in many ways by these electronic delivery vehicles.

Branches will remain an important vehicle in the foreseeable future. Indeed, branches are proliferating and many people can now do their branch banking at the local supermarket.

In fact, when the woman leaves her home and goes down to the local supermarket, she might find her bank there if she has a bank account. If she doesn't have a bank account, well, she might have direct deposit in any event.

But people who are unwilling or unable to make that trip to the local branch, whether it's in the supermarket or an old-fashioned brick and mortar branch, can now carry on a wide range of banking activities with ease.

In short, technology has opened more doors than it has shut. And it has removed more barriers than it has created. And I think it promises to continue to do so.

One of the things I was struck by in listening to the testimony so far is that everyone is in agreement on the need for education. New technology demands a new language and a new understanding for those who are steeped the traditional methods of access.

Banks have worked directly and in partnership with community groups to provide training and education on banking issues to their communities. The educational outreach ranges from first-time home purchase counseling and consumer credit counseling to budget counseling, how to balance a checkbook.

Some banks have education programs through their local school systems. Banks fund grants for local groups to train community members in banking services.

Consumer education funds focus on the poor, the elderly, the disabled, and the non-English speaking. Banks produce written materials in English and in other languages on banking basic skills, budgeting, maintaining checking accounts

and electronic accounts and in other new skills.

New technology will call for additional outreach. Banks will do this because it is in their interest to do so. Customer confidence and market acceptance will demand it.

It will do no one any good for the technology to be deployed without the consumer understanding it. We would encourage others including the government to focus on education, on the safe and effective use of financial services and on the use of the available and developing technology.

Access to services by the unbanked poses new and difficult questions for the government as it tries to implement the directive to provide benefits electronically after January 1, 1999 and to the financial services industry and communities as banks expand their products and services to attract some of the unbanked into the system.

We are just beginning to learn about why some people do not participate in the system. People may lack a banking relationship for a number of reasons ranging from a distrust of the system to a failure to maintain a successful relationship in the past.

What is increasingly apparent is that we need to understand more about why people do not entertain banking relationships so that their needs can be met. Different needs call for different responses.

It is also clear that the cost of establishing and maintaining these new accounts must be thoroughly understood so that they can be reasonably priced as profitable, sustainable products.

CBA co-sponsored with the Comptroller a forum on financial access in the 21st century this past February for the purpose of determining who lacks a banking relationship and why and to begin the difficult process of determining what can be done to address the issue.

The participants included a wide range of experts including bankers, academics, and representatives from community organizations. A lot was learned that will prove to be of value in this endeavor, but much remains to be done.

We are continuing to work with the Comptroller and his staff to develop surveys and to develop an ongoing dialogue. Plus several of our member banks, I understand, have continued to work with the OCC to help develop workable market driven responses to this need.

With the assistance of our alternative retail delivery committee and community reinvestment committees, we look forward to an active role in the future. Thank you very much.

CHAIRMAN LUDWIG: Thank you very much. I have a couple of questions to start, and then other members of our task force will have an opportunity to raise their questions.

I was interested that Mr. Graves mentioned something that was certainly a controversial topic which was touched on by

one of the other panelists.

And I'd just like to go around and see what people's views are. I believe your view is that stored value cards should be issued exclusively by banks.

I'd be interested if others have a view on that. In the United States of course as distinct from Europe where that has been the rule in some countries, we've had more open system where others have thus far been permitted to issue these cards. Ms. Creque, do you have a view on this?

MS. CREQUE: We don't have a position, but we have a concern that the stored value cards of less than \$100 there be some protection there.

Because to a low-income person, \$100 is a lot of money not to have any reassurance that will be replaced. That's our concern.

CHAIRMAN LUDWIG: Thank you. Did I state your views as correct?

MR. GRAVES: Yes. We feel that I guess in going with what Chairman Greenspan has said previously that it's important not to overregulate or overburden electronic technologies or the growth of electronic technologies at this time, it's important to provide that all stored value cards be given deposit insurance and be issued solely by banks to ensure that there is adequate protections and regulations of such.

CHAIRMAN LUDWIG: Mr. Harshaw.

MR. HARSHAW: Early on, I think that was our same position. Again, after hearing Mr. Levine's testimony here today, I was encouraged by his testimony of some of the state regulations that are involved.

I think we took that position primarily because we see this as a new bursting upon the economy, not unlike when years ago banks were allowed to offer bank notes of different banks all around the country.

And everybody had a very beautiful certificate. And you carried it around in your pocket. But when the time came to redeem it and you found out that the bank had gone under and it closed or left town, then there you were with the beautiful certificate, some of which you can see at our museum here in Washington, that in fact was worthless.

And we just felt that in the beginning, it was important to check all of those fraudulent, undercapitalized, misrepresenting issuers from the marketplace up front instead of at the back end trying to run around with a very small police wagon that we know we have to try and round up all these criminals.

So, we were motivated by the fact that (1) financial institutions have first of all a fiduciary responsibility to that customer in that community.

And also those that are federally insured and come under CRA regulations also have some responsibility to that

community to reinvest some of those profits back into those communities.

CHAIRMAN LUDWIG: Mr. Zeisel?

MR. ZEISEL: I agree that obviously banks have a fiduciary responsibility and that the trust factor is paramount here. One of the things that banks hear repeatedly, and every time they do a survey, and every time they talk to their customers is that customers trust banks.

And that trust factor I think can't be emphasized too strongly. And neither can the protection of the payment system. And I'm glad that that aspect of it is being examined closely by the regulators.

And I agree with Ms. Creque that protection of the customer is the bottom line in whatever systems develop. And I think we're in the early stages. So, it's probably too soon to say.

CHAIRMAN LUDWIG: If my fellow members of the panel will indulge me with one more question, I thought it was very poignant Mr. Graves' description of the one household that had every computer tool known to man and the other woman trying to get groceries in the more difficult community.

And we did, in fact, this morning hear about one store. I guess it was Scan that does not in fact take cash. So, this is not a completely hypothetical situation.

One solution I guess you alluded to, Mr. Harshaw, is simply require that everybody have them even if it takes government money, that is, point of sale reading devices even if it takes taxpayer money to do that.

Mr. Graves and Ms. Creque, do you have any other solutions in mind to the dilemma of a robust environment for stored value mechanisms such that it would force out cash?

Not that we're going to be there. The other panelists this morning suggested it's not going to happen anytime soon.

MS. CREQUE: While that may occur, we still must recognize that there is a segment of the senior population that will never accept SVCs. I'm talking about some who don't even speak the English language.

So, that's a first barrier to overcome. Some who are reliving the Depression days. And unless they have that money in their hand to actually count it and unless they have a document to show that that bill has been paid, that is a big challenge for us.

Because that is ingrained in some of our seniors. And the other thing. Remember that access is not always easy for seniors, many inner city seniors. Even buying groceries, to get there can be a challenge. So, these are some of the concerns of the association.

CHAIRMAN LUDWIG: That's very helpful. Mr. Graves, you posed a problem. Do you have a solution?

MR. GRAVES: Well, first I'd have to say that in the

alternative that I would suggest by no means is I guess better in our view than having an actual bank in a particular underserved community.

Having said that, I would agree with Mr. Harshaw that part of this problem can be solved with kiosks, point of sale devices as well as computers, computer donation programs established by banks that may not have locations in communities or computer banking centers as alternatives.

But at the same time, I still think that we need to look at other alternatives as well.

CHAIRMAN LUDWIG: Any other panelists?

MR. HARSHAW: Yes, I was encouraged in talking to some of the Congressmen on the Hill that they plan to introduce some financial literacy legislation here soon.

Because it's their feeling that even at a junior high school all the way up through college level, that our knowledge of financial institutions and financial transactions are probably back in the Stone Age.

And if that does happen, it would at least be another vehicle that we can start to move forward with this problem. You know, you've got other problems in inner cities even if you have a stored value system and you have a point of sale terminal.

Let's take for instance if you stick that stored value card, as Ms. Creque and I spoke, into a parking meter in the inner city. Well, you don't pay the nickel that you pay in the suburbs.

You pay 50 cents or 75 cents. This is also an opportunity for business establishments to start to raise prices so that in a case where normally you've been getting a loaf of bread at the store for --

I don't know what it is. I don't do the shopping. My daughter does. Let's say \$1.35. I guess you can buy a loaf of bread for that. That now it's \$1.60.

So, there are a lot of parts of this new developing technology that we're going to have to start to look at. Although, we would hope, and that's why I think it's important that all those businesses within those communities have the ability to access that because that allows the competition. So, that you just don't have one or two people redeeming the stored cash.

MR. ZEISEL: It strikes me as ironic. I agree with you that it does appear that students don't get an education or a grounding in the banking system.

I know I didn't. And I'm sure it's every bit as bad today. Although it is ironic that the students on the college campuses today are the ones who have the pilot programs in effect that are naturally developing in stored value systems where their use of the card within the context of the campus is a close approximation of the kinds of things that are developing on a wider basis and gives them a kind of a leg up, a head start in

comfort.

I can't quote a survey on it, but my recollection is that they're the ones who have the highest comfort level with this. At least that would seem to make sense.

And it is true that the elderly are probably the least comfortable with it initially as these technologies develop. I might respond to what Mr. Harshaw said about businesses increasing their charges in these communities.

And I suppose that's always possible. It is possible also that market forces could allow costs to decrease since stored value cards provide an ability for the merchant to reduce the possibility of certain theft loss.

And probably there are other cost savings in the process for them as they don't have to handle cash in the transaction. So, those cost savings to the extent that they can be and are passed on will be beneficial indirectly to the customers in those communities and everywhere else.

And to the extent that they're desirable for the merchants, the merchants will employ them in those communities as they do everywhere else.

MR. HOVE: Ms. Creque, I certainly understand the concerns that older people have in utilizing these things. But would you agree there are some advantages in using the stored value cards for older people in that a lost card can be replaced or there isn't the threat of crime with lost cards?

Is that somewhat offsetting to the disadvantages for older people to use the cards?

MS. CREQUE: Well, some older people will be receptive. I'm considered a younger senior. I use ATMs. I use a computer. I came out of that environment.

We also know that more seniors are purchasing PCS. They're slowing approaching what younger people are. Yes, they will learn to use them. But we have to have the proper education.

We have to have the proper safeguards in place. And one critical piece that we need as we move into this environment, should an error occur regardless where that error occurred, some efficient way for a person to resolve that.

What I hear from seniors is they hate this talking phone, push one, push two, push three. But should an error occur, somewhere that they could get to a human being who can help them resolve the issue.

I'm not saying that all seniors will not accept it. But I'm saying we have a tremendous job assuring them that it's a safe environment, that their money is protected. And also letting those persons who do not want to avail themselves of this new technology, give them an out.

MS. BERNSTEIN: Could I follow up on that, Gene? Several of you, and you particularly mentioned the need for education. Would you have comments on the best source of

education and the ways in which the government, if it can, can stimulate that kind of education?

MR. HARSHAW: Well, I don't know of any model in the past that I can refer to that's made that possible. I think we're at a new phase because there are a lot of different things that you have to learn.

Just the terminology that's going to be used with this new technology is enough to keep you away from it. I think we all have to gather and sit down together and start to develop whatever that curriculum will be.

And it will probably be different for different locations. As I've stated on a lot of Native American populations, there is a different educational process than there will be inner city Harlem which will be totally different from rural Tennessee.

So, I think depending on who the issuer is and as this market falls out and starts to settle and all the ones that did not do well have gone away and we get to see who the winners are, then I think you can start to turn education toward what are the benefits and hazards of the players that are still left around.

I think early on in this process, there are going to be too many issuers, too many different types of cards to be able to adequately cover all of the things that you have to watch out for when you're getting a stored value card.

And as you know, as we sit here today having this discussion on the positive ways that we can make this a much better and better functioning system that there are those who are out there who are trying to beat this system who are gathered in a similar place talking about ways that they can issue cards to beat us.

So, I think as time evolves and we have the shake out in this industry of the players that have gone away because they didn't have the capital, because their product was not accepted, because the customer didn't trust their product that we'll be in a better position to know what types of educational products we'll need to have.

MS. CREQUE: We would be willing to work with you for education. Currently today, we are involved in some financial education.

One of our most successful programs is entitled Widowed Persons. And you'd be surprised how many women suddenly are widowed, don't know how to handle finances.

We run an educational program starting ground level with budgets, writing checks. We also run several seminars with our seniors about financial fraud. So, we start at the basic level and start to build on that.

And that is our thrust to be a dynamic presence in the community, to make the experience of aging an enjoyable one for people. And education is a big component of that.

MR. HARSHAW: If I might add, similarly I guess over my

career just as a personal choice, I've always gone into senior citizen homes and surroundings to talk to senior citizens about financial literacy.

I'm always amazed when I broach the question of, "Do you have a joint account with another relative, and is it a payable on death account? Or is it joint?" and help them to understand that if for some reason that person didn't pay their federal income tax or something else that there's access to your money.

I always get these people that come up to me afterwards and say, "I need to talk to you after this session is over." So, I agree.

And I'm sure most of the organizations represented here would be more than willing to come together and work with you on that education model.

MR. ZEISEL: I'll second that. We'd be happy to work with you. I think that what I said about financial institutions feeling that it was in their best interest has fueled a huge growth in recent years in various educational approaches taken by institutions.

And many of them, I think, have involved partnerships with local communities and community organizations because of the obvious advantage that the community organization has in understanding the needs within those communities.

Those partnerships have been ground up. And I don't know what kind of national models are possible from it. But at least they have proved to be beneficial on a community-by-community basis from all I hear.

And I know that the federal government has done some things. For example, the Federal Reserve Board undertook some seminars on investment products. And there are other things of that type that have been employed in the past.

But encouraging partnerships sounds to me like it might be one of the more valuable approaches.

MR. GRAVES: I would agree that partnerships are probably the best way to go. And I'd also like to give you a few examples of the types of things that could be done.

In the past, and I know this from personal experience, there were programs in elementary schools around passbook savings accounts where students would have a savings account.

And every week you'd bring in your money to the school. And you would chart how much money you had, and that would be your savings account. Similarly, you had model store programs where the students would have a pretend store.

You could do the same type of thing with these new technologies where you're learning how to use ATMs or computers with point of sale devices and the like. You could do the same thing with churches.

Churches are probably the best resource for a number of the underserved groups in this country, especially for seniors,

reaching out to coalitions of churches and pastors to get people to come in and provide training to people in the churches whether that's bible study groups or any other groups that are there in the churches.

You could also look to government programs that are already going on like public housing. Those people who live in public housing have yearly interviews.

At these interviews, you might be able to spend 15 minutes explaining the new types, like, for instance, EFT explaining how EFT works or direct deposit works.

Partnership with industry could also provide economic training let's say in job training programs. People who are going back to get retrained around a certain job could also get training around economic issues.

So, I think that by working with a number of different groups, you may be able to come up with more ideas like these.

COMMISSIONER MORRIS: Mr. Graves, maybe I misunderstood what you're saying. But it seemed to me that you were saying that you thought having a unique license for stored value cards with commercial banks could create the vehicle through which the banks would begin to move in to underbanked communities and begin to offer more services.

I have a little trouble dealing with that because banks have had for years and years a monopoly on checking accounts. And I don't see them using that as a vehicle.

The flip side to what you're saying might be that if you had more of a proliferation of offerers, you would have more competition and prices might be lower.

MR. GRAVES: I would agree with some of what you're saying. But I guess the problem that we see in allowing proliferation of different issuers is security and safety and soundness problems with the banking system.

Just like Mr. Harshaw has already stated, there could be instances where an issuer goes bankrupt, and without the FDIC insurance, there's no protection for those consumers who have used it.

Now, I agree with you that banks have not gone into communities like we would have liked. But with the types of programs that we see the government doing over the past few years, specifically with CRA reforms and things that the OCC and other regulators have done, hopefully, I guess I'm being optimistic, but I would think that it benefits the community to have --

COMMISSIONER MORRIS: The triumph of hope over experience.

MS. CREQUE: Part of the reason why you have some unbanked seniors is because number one, there were no banks in their neighborhood. Number two, some of the minimum balances required.

When your sole income is this check coming from the

government, you don't meet it. Also, you will find that many low-income people are the greater users of the service.

They want to come in and see the teller more. And I'm from Chicago, and we did not have that situation. Now, we have an expansion of banks in low-income neighborhoods.

Surprisingly, they're opening branches in the retail stores, in the supermarkets. So, people feel protected going to that environment. It's very bright and well lit.

But they accomplish two things with one trip. They shop and they do their banking. The other thing that I wanted to say is that not only minimum balances, but when you have the banks coming back in the neighborhood, we're going to have these other charges possibly for the use of the ATM machines.

And when you look at low-income people, they need every penny that's coming in. So, those are some of our concerns.

MR. HARSHAW: Yes, if I can piggy-back on that. I think one of the things that Don has pointed out is there is some experience out there now.

When we first started with CRA more than 20 years ago, we went through that battle of non-acceptance. And a lot of financial institutions viewed it as a social program.

And now, we've come to a new time when those financial institutions have worked their way through that. They see profit. They've built coalitions not only with the community-based organizations, but with other people within that community.

And I think those coalitions, as Don has pointed out, are very strong so that you're not at the point of trying to get financial institutions and other people to accept this new technology and to develop partnerships. They already exist as you move upward.

And I think it is our greatest hope that this opportunity that we have with the new law for electronic benefits transfer is that we seize up on it not to try and figure out the best way to keep people out of the banks, but the opportunity that we can direct and help banks to develop banking services so that the unbanked are drawn into banking services to allow them the opportunity to get a home improvement loan if they need it, to get their roof fixed if they need some type of loan and not just be pushed away to ATMs, to point of sale terminals, and other devices like that.

CHAIRMAN LUDWIG: I was interested, Ms. Creque, do you see any particular benefits to seniors in the use of these new technologies, particularly the card?

You partially addressed this earlier, but just to focus on it a bit more. Are there particular aspects to the new technologies that could be improved or particularly address seniors' needs so that they'd be more attractive to seniors?

MS. CREQUE: Well, one particular aspect would be one of security. We know, today, for example, when checks are issued there is the possibility of it being stolen right out of the mail

box.

So, if they go to a local area, one of security knowing that the money was received and was deposited. There starts our education, it was deposited, in what format, how do they access it.

So, I see one of safety because seniors are vulnerable going to a bank, going to a currency exchange. The other aspect of it is we run a program, money management, for those seniors who receive money, but kind of forget they received it, and don't pay bills on a timely basis.

This could help some of our volunteers, younger seniors in being more efficient in administering that program. And that is a big program for us.

CHAIRMAN LUDWIG: That's very helpful. I don't know whether it was Mr. Graves or Mr. Harshaw who mentioned the issue of fees.

To what degree do you view those as something that would be particularly discouraging for the use of these card technologies in low and moderate-income communities and is there a fee structure that works better or worse?

MR. GRAVES: Well, I'm not sure that there is one specific fee structure that works. I mean, it would best be studied a little bit.

But I do think that we have to be sure that we do set up a structure that takes into account user's ability to pay for such fees and also takes into account the fact that financial institutions and others are actually getting a great deal of cost savings by using these technologies.

I think that for a large financial institution there is a savings of nearly 80 cents per transaction when using ATM transactions over teller assisted transactions.

I think it went from 27 cents to \$1.07. So, if you can imagine what that amount would be over the long run for all the different ATMs that they have, that's millions and millions of dollars.

I think that those fees that are going to be charged should also account for the money that's being saved by the bank.

MR. ZEISEL: Can I address myself to that just briefly? I agree with you that no one fee structure is necessarily clearly the best at this point. And fees are definitely an issue.

They're an issue of access, an issue in all cases. There is a lot we need to know about who the unbanked are and how they might undertake to use ATMs or any other banking services before anybody can structure fees in a way that is reasonable or profitable.

It wouldn't be clear at all, for example, how often someone would withdraw funds from an ATM if they were getting a direct deposit if they are currently unbanked.

I just don't think we know. Institutions currently don't know where the unbanked are located geographically, what

kinds of funds are coming into their accounts. And all those things have a bearing on determining the correct pricing of the account.

In terms of cost savings on ATMs, I can't dispute your figures because I don't have anything in front of me. But it seems to me that there are vast differences in cost savings.

There are differences among ATMs depending on whether they're on premises or off premises, differences depending on whether the customers are using the ATMs, or using ATMs and are using branches.

One of the problems that institutions have found in trying to save through the use of ATMs is that they find that as they add new technologies, people don't use the new technologies in place of the old technologies.

They use them in addition to the old technologies. So, what happens is the new technologies don't provide the initial cost savings that were anticipated.

That probably will happen down the line, but the curve is a different one than you might expect. And that probably will remain true with new stored value systems or home banking or anything of that nature. So, I just wanted to point that out.

MR. HARSHAW: If I could add and agree with what has been said that in a lot of communities the use of different technologies almost lags behind one generation like many years ago in most African-American communities, I know my grandfather, at least my grandmother because my grandfather didn't have access to my grandmother's pocketbook.

And that's where most of the funds stayed for a while. After a while, got ready to pay the rent and understood that there needed to be a receipt, that community went to money orders because it was quick. It was efficient.

It cost a dime, a nickel, not much. And it was certainly less costly than whatever the cost for going to a bank, depositing your money, and trying to earn some interest and whatever fees for writing that check were.

As we moved to check writing, they stay that, money orders. And probably as we move to stored value cards, they'll move to check writing if the fees involved are less than the transaction costs that are going to be involved with the new stored value cards.

So, there will probably always be some people outside of that system that you will probably call unbanked. And I agree with Ms. Creque that there will have to be some exemption given to those people who will probably stay outside of that market.

In addition, for a lot of those people, getting the monthly check is a social event. I mean, it's a time to go down, and you see your old friends. You wonder who's still around, how the babies are doing, who the grandkids are.

You can't do that at an ATM, and you can't do that at a point of sale terminal. So, there is a lot cultural and

different things involved when you get ready to talk about fees.

And I agree that it almost has to be based on who you're dealing with here that you start to structure fees. And I agree. I think it's too early for us to know that.

CHAIRMAN LUDWIG: I take it that it's implicit in your comments about education that this is not just education in the new technology, but sort of an undertone that in fact education in the financial area generally is lacking.

And this is an important new piece of that. But am I right that your comments really go to a broader educational issue?

MS. CREQUE: Right. More than just the use of the ATM because I agree with what John has said, many people don't know what a check is, what the difference is between a check and an overdraft.

And believe it or not, you give them the book and the checks, and they'll write the check. The money may not be there.

MR. HARSHAW: That's right.

MS. CREQUE: But they haven't connected this yet. So, we're talking about basic education, financial education.

MR. HARSHAW: I agree. And it reminded me of an example when I was in banking. A kid came in, and he opened a checking account. And he said, "Well, you have to put \$100 in to start this account." And he did.

He put \$100 in. He got his checks. And he just started writing checks. He'd written like \$500 worth of checks. He called him in and said, "Wait a minute. Wait a minute. Wait a minute. You've got to stop. You've written \$500 worth of checks."

He said, "Well, I got a lot of checks left here. I don't know why you want me to stop." In our community, we raise the girls and let the boys grow up.

And that happens in financial literacy. There are a lot of young men who have no concept of what happens in a financial institution, have no concept of what a checking account is, have no concept of what exchange rates are, anything that is associated with that.

And it even goes to little things. And of course, dear ladies, we've been beat up on the commercials. We don't know what cough syrup to buy. We don't know what washing powder to buy.

That's all the stuff you're supposed to know. And I was intrigued in a Laundromat that a young man came in to wash his clothes. And he was looking around.

He didn't know what to do. And the lady told him, "Look. Just get some money. Put it in the washing machine, get some soap powder, put that in there. The machine will take care of it."

And he went straight over to the dryer, threw his clothes in and sprinkled washing powder in the dryer, put his

money in, and let the dryer start to go.

Now, that level of education just for him in stepping out and being a responsible part of his family, if you can see it there in just washing clothes, you can imagine what it's like when you try and tell him you've got a job.

You've got a family. You need to start some banking services. You need to save some money for your children's education. Because that's going to be a big hurdle in a lot of those communities.

MR. ZEISEL: I think I did that when I went to college the first time I washed. But I think at the risk of saying the obvious, it seems to me that having listened to some of the discussion earlier about disclosures, one of the things that strikes me is that the disclosure issue is inextricably bound up with the issue of education.

And you see it in other areas as well, whether it's truth in lending or RSPA or any of the other myriad of regulations that as you think about what the disclosures ought to look like and what should be required and what should be not required and what do consumers know and what they don't know, it all seems to come back to the question of, "How much should they learn in a more general sense as part of their education so that you don't have to repeat it on every document?"

And if you have to tell them everything, if you have to give them a broad, general education with each document, then you're kidding yourself if you think they're going to learn it or read it or understand it.

So, if you can get to that basic level in a broader way, then the individual disclosure becomes an easier issue to deal with.

MR. HARSHAW: And then, finally, on this notion the end use is having these point of sale terminals, I hope we realize that we're not just talking about that community that's walking around with stored value cards.

We're talking about an international population especially here in Washington who comes and visits our great and fair city, and places like Japan who've had stored value cards for a long period of time who are walking around with them in their pockets that we want to be sure that those merchants in those communities have access to those stored value dollars that are still walking around the streets.

CHAIRMAN LUDWIG: Well, if there are no other questions, I want to thank you very much for coming. As the other panels, this has been a really high-quality, informative session, valuable for all of us.

I want to thank you for coming and sharing your time and your expertise with us today. I think it's been a good session. I think we learned a good deal. And I appreciate everybody for coming and taking the time.

Let me close this with our thanks. And our next and

final public meeting will be on July 17th at the FTC. We look forward to seeing some of you there. Thank you very much.